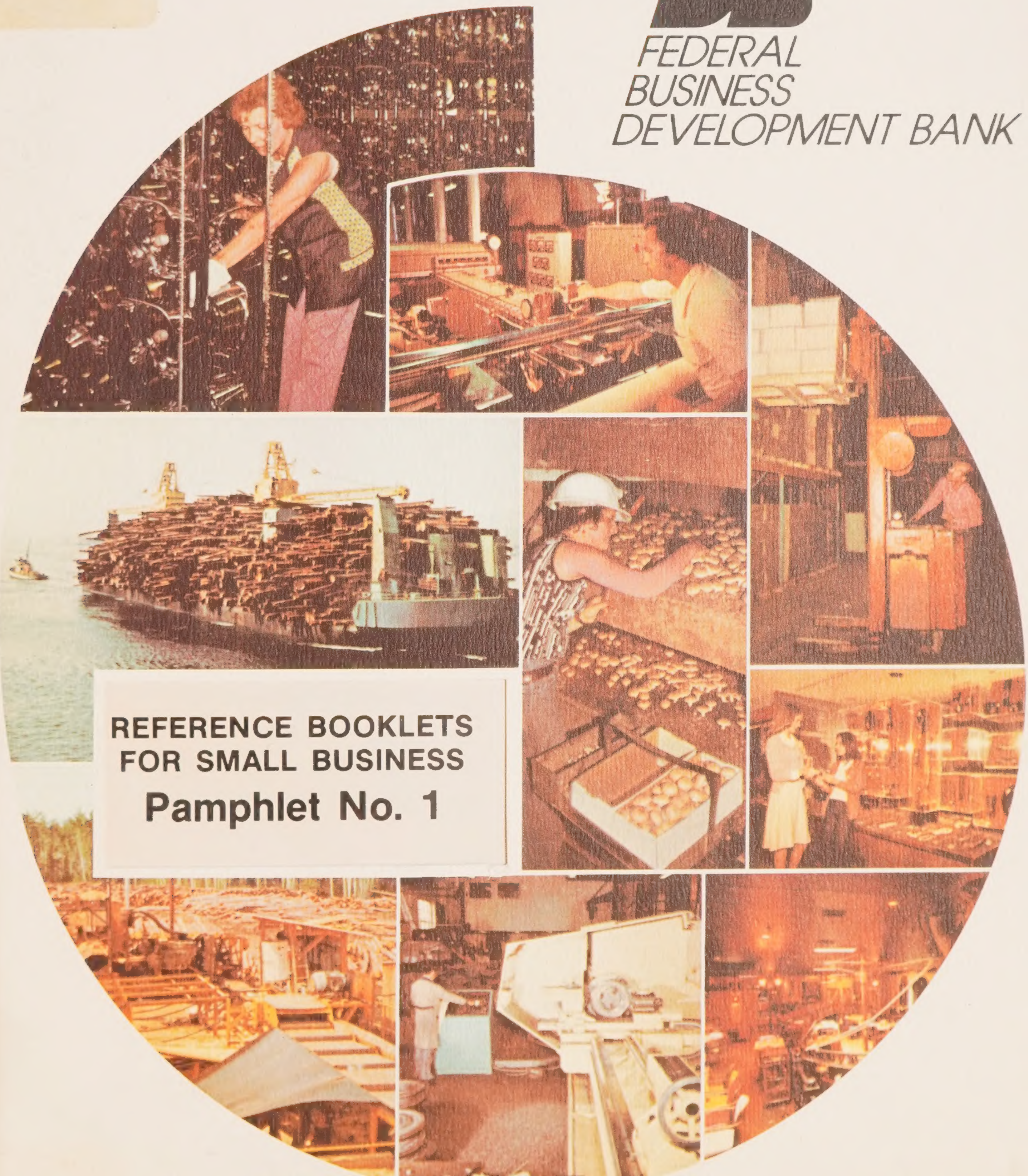
Minding your own business

FEDERAL
BUSINESS
DEVELOPMENT BANK



REFERENCE BOOKLETS
FOR SMALL BUSINESS

Pamphlet No. 1

[redacted]

MANAGEMENT SERVICES

The Federal Business Development Bank provides financial and management services to new or existing businesses anywhere in Canada, particularly those of smaller size.

Helping to promote sound management practices in small businesses is an objective of the Bank's management services. As part of this program, FBDB is publishing this series of pamphlets. Copies may be obtained in English or French without charge from any FBDB office, or by mail using the Order Form in the back of this pamphlet.

REFERENCE BOOKLETS FOR SMALL BUSINESS

Pamphlet No. 1

FEDERAL BUSINESS DEVELOPMENT BANK

P.O. BOX 6021, MONTREAL, QUE. H3C 3C3

Table of Contents

Foreword

This pamphlet consists of a listing of reference booklets, either free or of low cost, that may be of interest to you and/or assist in managing your business.

The pamphlet is divided into two sections. The first, headed "**Reference Booklets**", lists the publications by business sector or topic. The title and price of the booklet is given along with an identification number of the publisher. The second section of this pamphlet is entitled "**Publishers' Addresses**" and lists, for each identification number of the publisher, the name and address of the publisher.

By using these two sections, you will be able to locate under the business topic or sector the booklets available and, by using the publisher's identification number, key the number to the name and address where you order each booklet.

The following illustrations explain the layout of this pamphlet:

Business sector
Title of booklet
Publisher's identification number
Price

7. Tourism Canadian Menu Manual: Recipes and Menu Ideas for the Foodservice Profession **(FG5)** $2.75

Publisher's identification number
Publisher's name and address

FG 5 Supply and Services Canada
Publishing Centre
Printing and Publishing
Hull, Quebec
H1A 0S9

Sample copies of all publications listed in this pamphlet may be seen at any FBDB branch.

NOTE: *Orders for publications must not be sent to the Federal Business Development Bank. Order only from the names and addresses listed in the section "Publishers' Adresses".*

Reference Booklets

Prices subject to change

1. **Agriculture**	The Banks' Role in Farm Financing **(C2)**	Free
	Guide to Federal Agricultural Services (Pub. 1262) **(FG1)**	Free
2. **Exporting**	Canadian Customs Duties ("Doing Business in Canada" series) **(FG4)**	Free
	Exporting **(A1)**	$2.00 US
	Exporting - Importing ("Your Business Matters" series No. 4) **(C18)**	Free
	How to Finance Exports **(C2)**	Free
3. **Franchising**	Franchising **(A1)**	$2.00 US
4. **Manufacturing**	* How a Manufacturer Can Profit from Facts **(FG7)**	Free
	Management Audit for Small Manufacturers ("Small Business Management" series) (Stock No. S/N-045-000-00151-2) **(A2)**	$1.60 US
	Profitable Small Plant Layout ("Small Business Management" series) (Stock No. S/N 045-000-00029-0) **(A2)**	$0.80 US
5. **Retailing**	Apparel Stores **(A1)**	$2.00 US
	Auto Supply Stores **(A1)**	$2.00 US
	Bookstores **(A1)**	$2.00 US
	Consumer Electronics Centers **(A1)**	$2.00 US
	Crafts Are Your Business **(C5)**	$3.50
	Gift Stores **(A1)**	$2.00 US
	The Handcraft Business **(A1)**	$2.00 US
	Health Food Stores **(A1)**	$2.00 US
	Home Furnishings Stores **(A1)**	$2.00 US
	* How a Retailer Can Profit from Facts **(FG7)**	Free
	Independent Camera Shops **(A1)**	$2.00 US
	Mail Order Enterprises **(A1)**	$2.00 US
	Management Audit for Small Retailers ("Small Business Management" series) (Stock No. S/N-045-000-00149-1) **(A2)**	$1.80 US

**First copy in free; prices for additional copies available on request from publisher*

Available only from the sources indicated

Prices subject to change

	Plant Shops **(A1)**	$2.00 US
	Sewing and Needlecraft Centers **(A1)**	$2.00 US
	Shoe Stores **(A1)**	$2.00 US
	Toy and Hobby/Craft Stores **(A1)**	$2.00 US
6. Service Industry	Bars and Cocktail Lounges **(A1)**	$2.00 US
	Building Maintenance Services **(A1)**	$2.00 US
	Dry Cleaning Services **(A1)**	$2.00 US
	Hairgrooming/Beauty Salons **(A1)**	$2.00 US
	Restaurants and Food Services **(A1)**	$2.00 US
7. Tourism	Canadian Menu Manual: Recipes and Menu Ideas for the Foodservice Profession **(FG5)**	$2.75
	Design in Tourism: Accommodation **(FG5)**	$2.75
	Design in Tourism: Restaurants **(FG5)**	$3.50
	Directory of Courses - Tourism, Hospitality, Recreation **(FG3)**	Free
	Environmental Health Guide for Mobile Home Parks **(A3)**	$3.50 US
	Environmental Health Guide for Travel Trailer Parking Areas **(A3)**	$3.50 US
	Federal Government Programs Relevant to Tourism Development **(FG3)**	Free
	The Inn Business **(FG5)**	$3.75
	Mobile Home Parks **(A1)**	$2.00 US
	Motel-Building for the Future **(PG7)**	Free
	Planning Canadian Campgrounds **(FG5)**	$3.75
	Tourist Development (A Plan of Action for Tourist Development) **(C4)**	$0.75
8. Accounting and Financing	Beating the Cash Crisis **(A1)**	$2.00 US
	Cash Flow/Cash Management **(A1)**	$2.00 US
	Confirmation of Accounts Receivable (Cat. No. 120) **(C8)**	$3.00
	Confirmation of Trade Accounts Payable (Cat. No. 121) **(C8)**	$3.00
	Control over Direct Costs and Pricing ("Your Business Matters" series No. 6) **(C18)**	Free

Available only from the sources indicated

	Credit Management and Collection ("Your Business Matters" series No. 10) **(C18)**	Free
	Evaluation and Management of Fixed Assets ("Your Business Matters" series No. 11) **(C18)**	Free
	Financial Analysis for Credit Managers **(C6)**	$5.50
	Financial Recordkeeping for Small Stores ("Small Business Management" series) (Stock No. S/N-045-000-00142-3) **(A2)**	$1.55 US
	Financial Reporting and Analysis ("Your Business Matters" series No. 5) **(C18)**	Free
	Financing Canadian Industries **(FG4)**	Free
	Good Audit Working Papers (Cat. No. 123) **(C8)**	$3.00
	How to Read Financial Statements **(C9)**	$1.50
	Internal Control and Procedural Audit Tests (Cat. No. 125) **(C8)**	$3.00
	Investment Terms and Definitions **(C9)**	$1.00
	Materiality in Auditing (Cat. No. 126) **(C8)**	$3.00
	Overhead as an Element of Inventory Costs (Cat. No. 109) **(C8)**	$3.00
	Planning and Budgeting ("Your Business Matters" series No. 7) **(C18)**	Free
	Statistical Sampling in an Audit Context (Cat. No. 127) **(C8)**	$3.00
	Terminology for Accountants **(C8)**	$7.50
	Understanding Financial Statements **(A1)**	$2.00 US
	Use and Meaning of "Market" in Inventory Valuation (Cat. No. 111) **(C8)**	$3.00
9. Administration and Management	Accident Prevention **(C21)**	$3.95
	Avoiding Management Pitfalls **(A1)**	$2.00 US
	Bilingual Glossary of Terms and Expressions Used in the Office (Cat. W31-2472) **(FG5)**	$1.25

	Prices subject to change
Business Management: Advice from Consultants **(A1)**	$2.00 US
Control over Inventory Investments ("Your Business Matters" series No. 8) **(C18)**	Free
Crime Prevention for Small Business **(A1)**	$2.00 US
Does Your Business Need a Check-up? **(PG7)**	Free
An Employee Suggestion System for Small Companies ("Small Business Management" series) (Stock No. S/N-045-000-00020-6) **(A2)**	$0.45 US
Equipment Leasing **(A1)**	$2.00 US
Financing Small Business **(A1)**	$2.00 US
Good Management - Your Key to Survival ("Your Business Matters" series No. 3) **(C18)**	Free
Guides for Profit Planning ("Small Business Management" series) (Stock No. S/N-045-000-00137-7) **(A2)**	$0.85 US
Handbook of Small Business Finance ("Small Business Management" series) (Stock No. S/N-045-000-00139-3) **(A2)**	$1.50 US
How to Buy or Sell a Business **(A1)**	$2.00 US
How to Finance Your Business ("Your Business Matters" series No. 1) **(C18)**	Free
Human Relations in Small Business ("Small Business Management" series) (Stock No. S/N-045-000-00036-2) **(A2)**	$1.60 US
Improving Material Handling in Small Business ("Small Business Management" series) (Stock No. S/N-045-000-00041-9) **(A2)**	$0.75 US
Insurance and Risk Management for Small Business ("Small Business Management" series) (Stock No. S/N-045-000-00037-1) **(A2)**	$1.90 US
Insurance Guide for Credit Managers **(C6)**	$3.50
Internal Control in the Small Business **(C8)**	$3.00
Life Insurance and the Businessman **(C13)**	$3.95

Available only from the sources indicated

Prices subject to change

Management Succession **(A1)**	$2.00 US
Managing for Profit **(C3)**	$8.00
Managing to Sell ("Administrative Management Course Program" Topic 3) (Stock No. S/N-045-000-00091-5) **(A2)**	$4.00 US
Patterns for Success in Managing a Business **(C12)**	$1.95
Personnel for the Small Business **(A1)**	$2.00 US
Pointers to Profit ("Your Business Matters" series No. 2) **(C18)**	Free
Profitable Community Relations for Small Business ("Small Business Management" series) (Stock No. S/N-045-000-00033-8) **(A2)**	$1.50 US
Property Management **(A1)**	$2.00 US
Running Your Own Business **(C13)**	$3.95
Significant Aspects of Credit Management **(C6)**	$5.50
Small Business - Building a Balanced Economy **(C15)**	$2.95
A Small Business of Your Own ("Starting and Managing" series) (Stock No. S/N-045-000-00123-7) **(A2)**	$2.40 US
Small Store Planning for Growth ("Small Business Management" series) (Stock No. S/N-045-000-00152-1) **(A2)**	$2.20 US
Steps to Starting a Business **(A1)**	$2.00 US
Success and Failure Factors in Small Business ("Administrative Management Course Program" Topic 1) (Stock No. S/N-045-000-00083-4) **(A2)**	$3.65 US
Types of Security Available to Credit Managers **(C6)**	$3.50
What the Manager Should Know about the Computer **(C12)**	$2.95

Available only from the sources indicated

Prices subject to change

10.	Marketing and Advertising	An Advertising Guide and Planning Manual for the Canadian Small Business **(C19)**	$2.00
		Advertising Small Business **(A1)**	$2.00 US
		Creating a Market **(C21)**	$3.20
		Marketing New Product Ideas **(A1)**	$2.00 US
		Selecting Advertising Media - A Guide for Small Business ("Small Business Management" series) (Stock No. S/N-045-000-00154-7) **(A2)**	$2.75 US
		Why Customers Buy (and Why They Don't) ("Administrative Management Course Program" Topic 16) (Stock No. S/N-045-000-00086-9) **(A2)**	$5.25 US
11.	Business Locations	Alberta Business Index **(PG1)**	Free
		The Business Environment ("Doing Business in Canada" series) **(FG4)**	Free
		Canadian Business Guide **(C1)**	Free
		Doing Business in Canada **(C7)**	Free
		Doing Business in New Brunswick **(PG4)**	Free
		Doing Business in Ontario **(PG6)**	Free
		Establishing a Business in British Columbia **(PG2)**	Free
		Establishing a Business in Nova Scotia **(PG5)**	$0.85
		How to Establish a Business in Quebec **(PG8)**	Free
		Operating a New Business in Montreal **(C14)**	Free
		Starting a Small Business in Manitoba - A Guide to the Basic Legal Requirements **(PG3)**	Free
12.	General Business Statistics	* Business Failure Record-Annual **(C12)**	Free
		Expenses in Retail Business **(C16)**	$0.50
		Federal Incentives to Industry ("Doing Business in Canada" series) **(FG4)**	Free
		Investment in Canada **(C17)**	Free

**First copy in free; prices for additional copies available on request from publisher*

Available only from the sources indicated

		Prices subject to change
	* Key Business Ratios in Canada-Annual **(C12)**	Free
	List of Technical and Financial Aids from Federal and Provincial Governments to Commerce and Industry in Quebec **(C20)**	$5.00
	Sources of Information for Canadian Business **(C4)**	$3.95
	Statistics Canada Catalogue **(FG7)**	Free
13. Labour	Labour Legislation ("Doing Business in Canada" series) **(FG4)**	Free
	Labour Organizations in Canada (Cat. C2-2-1977) **(FG5)**	$2.50
	Labour Standards in Canada (Cat. L2-7-1976) **(FG5)**	$2.50
14. Legal and Customs	The Bankruptcy Act - The Privileges, Protection and Rights of Creditors **(C6)**	$3.50
	Condensed Laws of Business for Credit Managers **(C6)**	$3.50
	Construction and Equipment Standards ("Doing Business in Canada" series) **(FG4)**	Free
	The Credit Management Compendium - Facts and Forms **(C6)**	$3.50
	CSA Standards Catalogue **(C10)**	Free
	Forms of Business Organization ("Doing Business in Canada" series) **(FG4)**	Free
	Patents, Trademarks, Industrial Designs and Copyrights ("Doing Business in Canada" series) **(FG4)**	Free
	Quebec Minimum Wage Commission - Ordinance No. 3/No. 4 **(PG10)**	Free
	Selecting, Registering and Protecting Corporate Names **(FG2)**	Free

**First copy in free; prices for additional copies available on request from publisher*

Available only from the sources indicated

15. Taxes		Prices subject to change
	Income Tax and the Small Business **(FG6)**	Free
	Property Assessment in Canada (Tax Paper #50) **(C11)**	$2.50
	Taxation and Independent Business ("Your Business Matters" series No. 9) **(C18)**	Free
	Taxation-Income, Business, Property ("Doing Business in Canada" series) **(FG4)**	Free
	Taxation-Sales, Excise, Commodity ("Doing Business in Canada" series) **(FG4)**	Free

Available only from the sources indicated

Publishers' Addresses

A. American Publishers (U.S.A.)

A 1 Bank of America
Small Business Reporter
Department 3120
P.O. Box 37000
San Francisco, California 94137
U.S.A.

A 2 Small Business Administration
Superintendent of Documents
U.S. Government Printing Office
Washington, D.C. 20402
U.S.A.

A 3 Trail-R-Club of America
Box 1376
Beverly Hills, California 90213
U.S.A.

C. Canadian Publishers

C 1 Bank of Nova Scotia
44 King Street West
Toronto, Ontario
M5H 1E2

C 2 Canadian Bankers' Association
1801 McGill College Avenue
Suite 720, 7th Floor
Montreal, Quebec
H3A 1Z4

C 3 Canadian Business Magazine
59 Front Street East
Toronto, Ontario
M5E 1R5

C 4 The Canadian Chamber of Commerce
Commerce House
1080 Beaver Hall Hill
Montreal, Quebec
H2Z 1T2

C 5 Canadian Crafts Council
46 Elgin Street
Suite 16
Ottawa, Ontario
K1P 5K6

C 6 Canadian Credit Institute
931 Yonge Street
Box 500
Station "F"
Toronto, Ontario
M4Y 2L8

C 7 Canadian Imperial Bank
of Commerce
Business Development Division
Head Office
Commerce Court West
Toronto, Ontario
M5L 1A2

C 8 The Canadian Institute of
Chartered Accountants
250 Bloor Street East
Toronto, Ontario
M4W 1G5

C 9 The Canadian Securities Institute
P.O. Box 225
Commerce Court South
Toronto, Ontario
M5L 1E8

C 10 Canadian Standards' Association
Standards Sales
178 Rexdale Boulevard
Rexdale, Ontario
M9W 1R3

C 11 Canadian Tax Foundation
100 University Avenue
Toronto, Ontario
M5J 1V6

C 12 Dun & Bradstreet Canada Limited
P.O. Box 423, Terminal A
Toronto, Ontario
M5W 1E2

C 13 The Financial Post
481 University Avenue
Toronto, Ontario
M5W 1A7

C 14 The Montreal Board of Trade
1080 Beaver Hall Hill
Montreal, Quebec
H2Z 1S9

C 15 Burns & MacEachern
62 Railside Road
Don Mills, Ontario
M3A 1A6

C 16 NCR Canada Ltd.
1675 Trans-Canada
North Service Road
Dorval, Quebec
H9P 1J2

C 17 Peat, Marwick, Mitchell & Co.
Public Relations Department
P.O. Box 31
Commerce Court West
Commerce Court Postal Station
Toronto, Ontario
M5L 1B2

C 18 Royal Bank of Canada
(Branches throughout Canada)

C 19 The Women's Advertising Club
of Toronto
Book Order Department
P.O. Box 1019
Station "Q"
Toronto, Ontario
M4T 2P3

C 20 The Provincial Chamber
of Commerce of Quebec
500 Saint François Xavier Street
Montreal, Quebec
H2Y 2T6

C 21 International Labour Office
Canada Branch
178 Queen Street
Ottawa, Ontario
K1P 5E1

FG. Federal Government (Canada)

FG 1 Department of Agriculture
Information Division
Ottawa, Ontario
K1A 0C7

FG 2 Department of Consumer and Corporate Affairs
Corporations Branch
Place du Portage
Hull, Quebec
K1A 0C9

FG 3 Department of Industry, Trade and Commerce
Canadian Government Office of Tourism
235 Queen Street
Ottawa, Ontario
K1A 0H6

FG 4 Department of Industry, Trade and Commerce
Distribution and Publications
2nd Floor East
240 Sparks Street
Ottawa, Ontario
K1A 0H5

FG 5 Supply and Services Canada
Publishing Centre
Printing and Publishing
Hull, Quebec
H1A 0S9

FG 6 Revenue Canada Taxation
(Your Local District Taxation Office)

FG 7 Statistics Canada
User Advisory Services
4th Floor, Section 0
R.H. Coats Building
Ottawa, Ontario
K1A 0T6

PG. Provincial Governments (Canada)

PG 1 Government of Alberta
Department of Business Development and Tourism
19th Floor, Capitol Square
10065 Jasper Avenue
Edmonton, Alberta
T5J 0H4

PG 2 Government of British Columbia
Department of Economic Development
Information Services
Box 10111
700 West Georgia Street
Vancouver, British Columbia
V7Y 1C6

PG 3	Government of Manitoba The Small Business Centre Department of Industry and Commerce # 1 Lakeview Square 155 Carlton Street Winnipeg, Manitoba R3C 3H8	**PG 4**	Government of New Brunswick Department of Commerce and Development Information Office Box 6000 Fredericton, New Brunswick E3B 5H1
PG 5	Nova Scotia Communications & Information Centre Bookstore 1597 Hollis Street Halifax, Nova Scotia B3J 2T3	**PG 6**	Government of Ontario Ministry of Industry and Tourism Market Research Section Industry & Trade Analysis Branch 900 Bay Street, Hearst Block Toronto, Ontario M7A 1S8
PG 7	Ontario Development Corporation Information Office 900 Bay Street, Mowat Block 4th Floor, Queen's Park Toronto, Ontario M7A 1S6	**PG 8**	Government of Quebec Department of Industry and Commerce Communications Division 710 Place d'Youville Quebec, P.Q. G1R 4Y4
PG 9	Government of Quebec Department of Industry and Commerce 710 Place d'Youville, Ch: 204 Quebec, P.Q. G1R 4Y4	**PG 10**	Government of Quebec Le Directeur Direction des affaires publiques Commission du salaire minimum C.P. 18500 Terminus Quebec, P.Q. G1K 7Z5

F.B.D.B. Branch Offices

Atlantic Region

St. John's, Nfld. 737-5505
Beothuck Bldg., Crosbie Place,
P.O. Box 8805, Stn. A, A1B 3Y8

Sydney, N.S. 539-4556
48-50 Dorchester St.,
P.O. Box 726, B1P 6H7

Charlottetown, P.E.I. 892-9151
137 Kent St.,
P.O. Box 488, C1A 7L1

Halifax, N.S. 426-7850
Trade Mart, 2021 Brunswick St.,
B3K 2Y5

Moncton, N.B. 858-2370
860 Main St.,
P.O. Box 1090, E1C 8P6

Saint John, N.B. 658-4751
75 Prince William St.,
P.O. Box 7173, Stn. A, E2L 4S6

Corner Brook, Nfld. 639-7113
Herald Tower, Herald Ave.,
A2H 6G7

Truro, N.S. 895-6377
CN Commercial Centre,
34 Esplanade St.,
P.O. Box 1378, B2N 5N2

Fredericton, N.B. 452-3030
King's Place Complex,
440 King St., Suite 649,
P.O. Box 13, E3B 4Y3

Grand Falls, Nfld. 489-2181
42 High St., P.O. Box 744,
A2A 2M4

Bathurst, N.B. 548-3345
270 Douglas Ave.,
P.O. Box 780, E2A 4A5

Bridgewater, N.S. 543-7821
655 King St., P.O. Box 540,
B4V 2X6

Quebec Region

Sept-Iles, 968-1420
690 Laure Blvd., Suite 152,
G4R 1X9

Rimouski, 724-4461
320 St. Germain St. East,
G5L 1C2

Chicoutimi, 545-1580
475 des Champs Élysées St.,
G7H 5V7

Quebec, 681-6341
925 Chemin St. Louis,
G1S 1C1

Sherbrooke, 565-4740
2532 King St. West,
J1J 2E8

Trois-Rivières, 375-1621
1410 des Cypres St.,
P.O. Box 666. G9A 5J3

Longueuil, 670-9550
Complexe Bienville,
1000 de Sérigny St.. J4K 5B1

Montreal, 878-9571
800 Victoria Square, Suite 1008,
P.O. Box 187. H4Z 1C8

205 Place Frontenac, 524-1188
2600 Ontario St., East,
Suite 205, H2K 4K4

St-Laurent, 748-7323
750 Laurentian Blvd.,
H4M 2M4

St-Leonard, 254-6073
5960 Jean Talon St. East,
H1S 1M2

St-Jerome, 436-6441
Galeries des Laurentides,
St-Antoine des Laurentides,
P.O. Box 600, J7Z 5V3

Hull, 997-4434
Plaza Val Tétreau,
400 Alexandre Taché Blvd.,
J9A 1M5

Rouyn-Noranda, 764-6701
147 Mercier Ave., Rouyn,
J9X 4X4

Granby, 372-5202
161 rue Principale,
J2G 2V5

Drummondville, 478-4951
228 Hériot St.,
J2C 1K1

Valleyfield, 371-0611
85 Champlain St.,
J6T 1W4

Levis, 837-0282
113 St. Georges St.W.,
G6V 4L2

Lasalle, 364-4410
1550 Dollard Ave.,
H8N 1T6

Laval, 681-9289
2525 Marois Blvd.,
Chomedey, Laval,
H7T 1S9

Ontario Region

Ottawa, 237-8430
151 Sparks St., Suite 1012,
K1P 5E3

Kingston, 549-1531
797 Princess St., P.O. Box 265,
K7L 4V8

Oshawa, 576-6800
22 King St. West, P.O. Box 980,
L1H 7N2

St. Catharines, 684-1153
71 King St., P.O. Box 1193,
L2R 7A7

Toronto, 598-0341
204 Richmond St. West,
M5V 1V6

Toronto-North, 638-0823
4430 Bathurst St., Downsview.
M3H 3S3

Oakville, 844-0911
345 Lakeshore Rd. East,
P.O. Box 1090. L6J 5E9

Barrie, 728-6072
70 Collier St., P.O. Box 876,
L4M 4Y6

Hamilton, 523-2954
8 Main St. East, P.O. Box 619,
L8N 3K7

Kitchener-Waterloo, 744-4186
305 King St. West,
P.O. Box 428, Postal Terminal,
Kitchener, N2G 3Y9

Sudbury, 674-8347
96 Larch St., P.O. Box 820,
P3E 4S1

London, 434-2144
197 York St., Suite 1000,
N6A 1B2

Timmins, 264-9432
83 Algonquin Blvd. West,
P.O. Box 1240. P4N 7J5

Chatham, 354-8833
59 Adelaide St. South,
P.O., Box 815, N7M 5L1

Windsor, 254-8626
500 Ouellette Ave.,
N9A 1B3

F.B.D.B. Branch Offices (Cont'd)

Ontario Region

Sault Ste. Marie, 949-3680
452 Albert St. East,
P6A 2J8

Thunder Bay, 623-2745
106 Centennial Square,
P.O. Box 878, Stn. F, P7C 4X7

Kenora, 468-5575
20 Main St. South,
P.O. Box 259, P9N 3X3

Stratford, 271-5650
1036 Ontario St.,
N5A 6Z3

Woodstock, 537-5846
430 Dundas St.

Owen Sound, 376-4431
1139 Second Ave. East,
P.O. Box 266, N4K 5P3

Etobicoke, 239-4804
Valhalla Executive Centre,
304 The East Mall,
P.O. Box 474, Islington,
M9A 4X4

Scarborough, 431-5410
2978 Eglinton Ave. East,
P.O. Box 798, Stn. A, M1K 5C8

Peterborough, 748-3241
340 George St., North,
P.O. Box 1419, K9J 7H6

Prairie and Northern Region

Winnipeg, Man. 944-9991
386 Broadway Ave.,
R3C 3R6

Brandon, Man. 727-8415
136-11th Street, P.O. Box 6,
R7A 5Y6

Regina, Sask. 569-6478
2220-12th Avenue,
S4P OM8

Saskatoon, Sask. 665-4822
1102 CN Towers,
Midtown Plaza, S7K 1J5

Lethbridge, Alta. 328-9681
740-4th Avenue South,
T1J 0N9

Edmonton, Alta. 428-9111
10150-100th Street,
T5J 0P6

Edmonton South, Alta. 436-6533
11044-51st Avenue,
T6H 5B4

Red Deer, Alta. 343-3232
4919-59th Street,
T4N 6C9

Calgary, Alta. 269-6981
404 Sixth Ave. S.W.,
T2P OR9

Calgary South, Alta. 253-6501
5940 MacLeod Trail S.W.,
T2H 2G4

Grande Prairie, Alta. 532-8875
10135-101st Avenue,
P.O. Box 10, T8V 3A1

Yellowknife, N.W.T. 873-3566
5010-50th Avenue

Whitehorse, Y.T. 667-7333
Travelodge Commercial Mall

Prince Albert, Sask. 764-6448
1100-1st Avenue East,
P.O. Box 520, S6V 5R8

St-Boniface 233-6791
Bay 6 West,
851, Lagimodiere Blvd.
Winnipeg R2J 3K4

Edmonton West, Alta. 452-3232
11574-149th Street,
T5M 1W7

British Columbia Region

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linding your own business

FEDERAL
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GIVING CREDIT TO YOUR CUSTOMERS

Pamphlet No. 2

MANAGEMENT SERVICES

The Federal Business Development Bank provides financial and management services to new or existing businesses anywhere in Canada, particularly those of smaller size.

Helping to promote sound management practices in small businesses is an objective of the Bank's management services. As part of this program, FBDB is publishing this series of pamphlets. Copies may be obtained in English or French without charge from any FBDB office, or by mail using the Order Form in the back of this pamphlet.

GIVING CREDIT TO YOUR CUSTOMERS

Pamphlet No. 2

FEDERAL BUSINESS DEVELOPMENT BANK

P.O. BOX 6021, MONTREAL, QUE H3C 3C3

GIVING CREDIT TO YOUR CUSTOMERS

Credit has been defined as the ability to obtain goods or services in return for a promise to pay in future. More simply, it is a sale on trust. Why should you sell on trust? How do you know who to trust?

Every business has to face at some stage the fundamental question "Should we give credit to our customers?" The answer is not easy. For most businesses, the willingness to grant credit is important to their growth; to many it is essential to their well-being because their competitors offer credit terms. It is part of what they offer for sale.

The ready availability of credit is a major factor in our economic life. Credit buying has gained such widespread acceptance that its contribution to the economy and its significance to your business needs to be well understood. This pamphlet discusses some of the basic factors to be weighed in reaching a sound decision on granting credit.

THE ADVANTAGES

The advantages to both buyer and seller are real. The principal advantage of giving credit is that it increases sales by allowing goods or services to be purchased by customers who would otherwise be unable to do so, or who would purchase the same goods or services from others willing to offer credit. The customer, too, gets something out of it. It is convenient, and exchanges and returns are easier. He may be able to buy a little extra and increase his own sales. He will be a happy customer who will come back for more.

........AND THE DISADVANTAGES

The principal disadvantage for the seller is cost. When selling on credit a business is giving away its product, temporarily. Payment will not be received immediately but nevertheless the costs of producing the product must be paid by the seller. The effect is

the same as making the customer a loan. Greater amounts of capital must be available than would be required by a business operating solely on a cash basis and the cost of this capital is an added expense to the seller.

The costs of determining which customers are worthy of credit, as well as the costs of maintaining records of amounts owing, of billing and of collecting, are costs not faced by the cash business. Also, no matter how careful you are in granting credit, there will likely be some customers who won't pay, and the resulting bad debt expense is a very visible one. A less obvious drawback is that a customer is more likely to return or exchange goods for which he has not paid, with resulting inconvenience to the seller. The availability of credit may promote extravagance on the part of the buyer, or may even inadvertently encourage the seller to oversell his customer, leading him to purchase goods which he does not need and cannot afford. The seller ends up paying for such goods.

YOU MAKE THE RULES

Assuming you have weighed these points and have decided to offer credit to your customers, where do you start? By establishing the rules by which you will grant credit. Decide what terms will be offered and what limits will apply. Decide what discounts will be allowed for prompt payment. Remember that discount terms are sometimes misleading. For example, suppose you decide to offer terms of one percent, ten days, net thirty days. That is, if your customer pays within ten days, you give him a one percent discount, but if he pays during the twenty days remaining till the due date, he has to pay the full amount. This means you are charging him one percent more for a period of twenty days, if he takes thirty days credit, instead of ten days. At a glance you may not feel this is an attractive discount to offer but it amounts to $\frac{365}{20} \times 1 = 18\frac{1}{4}$ percent per year.

Decide what action will be taken when accounts become overdue and what interest rate will be charged to them. Each of these decisions should be reached prudently for the future of the business is at stake.

WHO CAN YOU TRUST?

Having established a credit policy, it is time to apply it. Evaluate each customer, whether you sell to firms or individuals. There is a sound, systematic way of doing this and the three basic characteristics most often looked for are the "three C's" of credit — character, capacity and capital. All three are essential and closely linked, but it is the character element which warrants closest scrutiny. Without it, capacity and capital have little meaning. On the other hand, shortcomings in capital and capacity can often be overlooked in the presence of credit character — the intention and, most important, the willingness to pay.

Start with a well-designed questionnaire form for credit applicants. Elementary details to be recorded on it include the customer's name, address and occupation, of course. Length of time at present address and frequency of moving. Amounts and sources of income. Financial obligations. Bank account. Credit cards.

Once a credit application is received, it's common practice to ask more questions — of the applicant's bank, trade organizations, his other suppliers and credit bureaux such as Retail Credit Company, Dun and Bradstreet and your local Credit Bureau. How much does he owe and to whom? Does he have a good payment record? Has he shown stability in his business background? Why does he need credit? If it is solely because he is short of cash, but otherwise meets the criteria which have been established, he may be an excellent risk. But if it is because he is short of cash and overextended elsewhere, he may be a poor risk. Good judgment in analyzing credit risks is vital for successful credit management. If you decline good risks, or accept poor ones, your business will suffer.

PUTTING IT TO THE TEST

Having decided to whom to give credit, the terms under which it will be offered should be set out and explained very clearly to each customer. In most cases a credit limit should be specified so the credit will not extend beyond the customer's ability to

pay. A cash downpayment on certain types of purchases is a useful deterrent to unnecessary or excessive purchases. The payment terms should be established carefully, in keeping with the nature of the purchases and the needs of the buyer. For example, don't allow several months to pay for perishable foods. In some cases, credit should be made available only until the customer's next pay day.

GETTING YOUR MONEY BACK

The best laid credit plan will fail unless an effective invoicing system is established and used. Forget to send your bills and some of your customers will probably forget to send their payments. A prompt reminder to a delinquent account will usually bring results, serving to reaffirm the rules under which credit was offered. If this doesn't work, a re-discussion of the terms of the credit should be conducted to determine the reasons for a customer's failure to meet his commitments. But use common sense and tact. Perhaps he isn't paying because of a temporary setback which might be alleviated by amending the credit terms. But if he has lost his willingness and desire to pay, further credit privileges should be withdrawn. Interest should be charged on the overdue account, or, if already being charged, the rate of interest should be increased. Such penalties will frequently have a chastening effect but, if they fail, act decisively through repossession of goods or other legal means.

Just as a credit granting policy is important, so is a credit collection policy, applied consistently and fairly, because it is the paid-up customer who can buy more and because prompt payment eliminates expenses caused by slow payment. Failure to take action, mildly at first but with increasing severity, on an overdue account can only encourage the delinquent customer to pay even less attention to his obligations. Care should be taken, though, when approaching the period for final action, to differentiate between customers able but unwilling to pay and those willing but unable to pay, or unable to pay within a reasonable time. In the latter case, patience may be less costly than legal action.

TAILOR YOUR OWN CREDIT SYSTEM

No attempt has been made in this pamphlet to describe the mechanics of setting up and operating a credit granting system. This will depend on the size and type of your business. The details of procedures, equipment and forms can best be designed and implemented by a qualified consultant, most often the firm's auditor or accountant.

Few factors in modern business contribute more to its growth than the sound use of credit. Giving it means taking some risks, but they can be kept to a minimum by consistently following sound credit policy and procedures. Giving credit to your customers will usually reflect credit on your business.

For further information that may assist you in managing your business we refer you to the booklets listed in F.B.D.B. Pamphlet No. 1 "Reference Booklets for Small Business".

CASE

Counselling Assistance to Small Enterprises

The Federal Business Development Bank's Management Counselling Services known as CASE (Counselling Assistance to Small Enterprises) assists small businesses in Canada to improve their methods of doing business.

Virtually any established business or anyone about to engage in a business enterprise can apply provided it has had prior discussion of its needs with its appropriate business advisor(s), and provided it has no more than seventy-five employees.

This service is provided at a moderate fee and supplements counselling services obtainable from the private sector. The counselling is performed by retired business persons selected for their management experience.

To obtain more details on CASE, contact any of the CASE offices listed below or any FBDB branch office.

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ST. JOHN'S	4th Floor-Beothuck Building	(709) 737-5515
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MONCTON	860, Main St., Suite 702	(506) 858-2973
FREDERICTON	440 King Street, Suite 646	(506) 452-3022
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Minding your own business

FEDERAL
BUSINESS
DEVELOPMENT BANK

PRESENTING YOUR CASE FOR A TERM LOAN

Pamphlet No.3

[redacted]

FBDB MANAGEMENT SERVICES

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PRESENTING YOUR CASE FOR A TERM LOAN

Pamphlet No.3

FEDERAL BUSINESS DEVELOPMENT BANK
P.O. BOX 6021, MONTREAL, QUE. H3C 3C3

PRESENTING YOUR CASE FOR A TERM LOAN

Regardless of where you seek term financing for your business, the information required by each lender will be basically the same. The lender will want to know

- WHO YOU ARE
- HOW YOUR BUSINESS IS DOING
  (Unless you don't have one yet)
- WHAT YOU PLAN TO DO
- WHAT YOUR PLAN WILL DO FOR YOUR BUSINESS

Naturally, the lender will also want to see how he might fit into your plan for the several years that you would use his money. The same things you would want to know if you were asked to lend your money for several years. For a small business, the preparation of this information, and the analysis that backs it up, can be quite simple. The basic points stated above lead to the main lending criteria used by term lenders in considering a proposal.

WHO YOU ARE

One criterion of great importance is the quality of management of your business. WHO YOU ARE gives the term lender a glimpse of what to expect from the management of your business. Your education, your experience (or lack of it), your

accomplishments, your shortcomings and who on your management team makes up for them, are all of interest. Jot them down. Term lenders can also compare, from their own experience, the relative strengths of your management with many other businesses, particularly those in your industry. Obviously your diligence and determination to make a success will be major factors, too. No management group in a small business is likely to look perfect to an outsider. Discussion of it with a term lender may sometimes lead you to make improvements that may eliminate possible future problems in management.

HOW YOUR BUSINESS IS DOING

Of greatest single importance to most lenders, and naturally to you, is the ability of your business to earn sufficient profits to repay the term loan, with enough left over to meet the normal needs of the business. Without this ability your business will fail. HOW YOUR BUSINESS IS DOING will tell part of this story.

So present your balance sheets and profit and loss statements for the past four or five years, if you've been in business that long. If you are starting a new business, show your balance sheet as it would look when you start, having obtained the financing required.

WHAT YOU PLAN TO DO

A concise way to show someone else, such as a term lender, WHAT YOU PLAN TO DO

is to make a tabulation of your plan and its financing, for example:

PROGRAMME		FINANCING	
Purchase land	$ 3,000	F.B.D.B. loan	$48,000
Construct building addition	50,000	Additional share-holders' investment	17,000
Purchase & install equipment	7,000		
Provision for contingencies	5,000		
	$65,000		$65,000

This presentation can then be expanded on by footnotes or attached sheets, giving the details of each item, e.g. the size, location and legal description of the land, the plans for the building addition, and so on.

You should indicate clearly which items of the cost are firm, and which are based on estimates only. In the example above a provision for contingencies of $5,000 is included to allow for such things as inaccuracies in estimating, items overlooked and changes during construction involving extra cost. The amount that you should provide for contingencies depends on the nature of your programme and the portion which is subject to estimates only. Even for the portion which is firm, there will often be changes made while the programme is in progress, particularly where it involves the installation of machinery and equipment. These changes often add to the cost of the programme. In some cases, a contingency reserve of at least 50 per cent is desirable even when a large part of the programme is covered by firm commitments. In the average case, a cost

overrun of 10 per cent to 20 per cent can be expected. A corresponding provision for contingencies at the outset will prevent a shortage of funds when your programme is only partially completed.

It is also important to demonstrate that your programme will bring tangible benefits to your business. In the case of a large sophisticated business, with careful control over capital budgeting, it is normal for a lender to require that an analysis be made of what is expected from a particular project by way of decreased costs and increased net revenues. For a small business, without the same degree of sophistication in capital budgeting, such an analysis is difficult to prepare. In any case, there should be some thought given to the potential savings to be derived from the programme. If the main purpose of the programme is physical expansion to take care of increasing sales volume, you must ensure that the expansion is in reasonable relation to the expected sales volume, as there are few businesses that can really afford to have a large amount of unused or excess capacity.

Finally, of course, would come details of the sources of financing proposed for the programme. Sometimes this would simply be the term loan itself but, in other cases, the programme might involve fresh investment by you, or perhaps the use of working capital. In the case of fresh investment, a lender will normally want you to satisfy him

that the money for it is available. If part of the financing is to come from working capital, it is helpful to have ready some analysis of how this could be accomplished without jeopardizing the working capital required for the normal day-to-day financing of the business.

WHAT YOUR PLAN WILL DO FOR YOUR BUSINESS

Your past financial statements only give an indication of what to expect from your business. WHAT YOUR PLAN WILL DO FOR YOUR BUSINESS is the more important part of the picture. What will your financial statements look like in the future? It is fairly easy to show what your balance sheet will look like right after your plan is completed. You will have more assets, purchased with the new financing. You will also have more liabilities, including the term loan, and perhaps there will be new investment by you and others. The term lender can help you make up this picture.

He will probably refer to it as a "pro-forma" balance sheet. But the main point is that it shows the immediate effect of your plan on your balance sheet. It might point out a strong point in your plan that you hadn't thought of. For example, it might show that the amount of new debt would not upset the balance of total debt to owners' investment that a successful business should maintain. It might show the reverse. The term lender can

advise you on that, too.

But you still haven't shown what your business will earn in the years following completion of your plan. You have shown a bit of the future in the pro-forma balance sheet, but now you have to look further ahead to see what your profit and loss statements will look like after your plan is completed. You are best equipped to do this, as no one else knows the details of your business like you do.

Visualize what your plan will do to each item on your profit and loss statements during the remainder of your fiscal year after the plan is completed. And don't forget new items of expense that may not exist now. First, estimate your new sales volume, realistically. Base this on a good knowledge of your market, not on hope. Then estimate your new labour and material costs, plant overhead, sales expenses, and administration and financial expenses. It is surprising how many of these would be affected, when you think about each of them. And they all affect your resulting profit.

To satisfy yourself further, do this for the next full fiscal year and the one after to demonstrate that a good level of profit will continue. If your plan is modest, requiring, say, a $10,000 term loan, this "earnings forecast" will be quite simple to calculate. If you need a term loan of several hundred thousand dollars, on the other hand, many items on your profit and loss statements would likely change considerably in the future.

In this case you would be wise to show these changes for several more years into the future.

Briefly then, the balance sheets and profit and loss statements of your business, for the past and for the future, are the main financial tools you should present.

SECURITY

Since most term loans are secured by the term lender taking a charge on the fixed assets of the business, it is apparent that the security value of these assets is also a criterion affecting the amount of term financing you might obtain. If the fixed assets of your business comprise only leasehold improvements, which usually have a very low relative recovery value in the event of liquidation, it is obvious that security values would be very low. On the other hand, a mortgage on a well-located, general purpose building of good quality construction, represents very good security. However, many lenders are prepared to make a loan which is under-secured by the fixed assets if the business has excellent earning prospects. Be prepared to describe your land, buildings, machinery and equipment.

FINANCIAL STRENGTH

Finally, there is the general financial strength of the business, now, and after your plan is completed. Will there be sufficient capital to meet trade debts promptly, to

survive seasonal lulls comfortably and to maintain good deliveries and service to your customers? Again your balance sheets and profit and loss statements will enable the term lender to make a few simple tests to satisfy him about your financial strength.

WORKING CAPITAL

The working capital of your business, expressed in accounting terms, is the excess of its "current" assets over its "current" liabilities. It should be sufficient to provide for the payment of current liabilities as they come due and for the financing of day-to-day operations.

There is no precise guide for the working capital needs of a small business, but the expected working capital position, after completion of your programme, should be looked at carefully to ensure its adequacy. Working capital needs vary from one industry to another. It is, for example, normal in the printing trade to have extended terms of as much as a few months available from suppliers, whereas a meat packer could expect at best ten-day terms from his suppliers. Some businesses sell on a cash basis and pay for their supplies on terms, so that they can conveniently operate with a working capital deficit.

The term lender can assist you to determine what amount of working capital your

business should need after your programme is completed. This can be compared with the amount it will likely have by that time, giving effect to any new funds from shareholders' investment and additional profits during this period, offset by payments for the new debt and possibly for liens, profits taxes and the like.

PRODUCTS AND MARKETS

If the goal of your programme is to expand productive capacity, a lender will naturally be concerned with the market potential for the present or proposed products of your business. This could involve some assessment of the competitive position of your business in its industry, or of the industry itself in relation to alternative products or services. This requires a look at such factors as prices, obsolescence, style, quality and design. Even though your business has been successful in the past with its products and services, this is not necessarily an assurance that it will continue to be successful. In essence, the lender tries to determine how solidly your business is established in its market, and the reasons for the unique success which it has or will enjoy.

Having obtained a good idea of products and markets, it is desirable to relate your physical expansion project to your existing plant facilities to ensure that there will be no

unforeseen bottlenecks, and that capacity of the enlarged plant will be reasonably well matched to the production and sales needs.

THE NEW BUSINESS

In the case of a brand new business, the analysis will follow along similar lines to those outlined. It is apparent though, that the projections, particularly the earnings projection, are most important as there are not past results to go by. Also several new factors will be introduced. In analyzing the project, it will be necessary to make provision for the inevitable "pre-production" expenses. Further, the average new business will probably suffer a period of cash losses as volume is building up, and there should be some money to take care of these.

A shortage of working capital is one of the most important features leading to bankruptcy of a new business. If a business gets into trouble, it is difficult to obtain additional working capital assistance. It is far better to provide for a comfortable amount of working capital at the outset. The new businessman should not skimp on this.

Another indicator which is often useful in looking at a new business is a "break-even" analysis. The break-even point of your business is that yearly volume of sales at which your business starts to make a profit. If your sales fall below this amount, your business

will show a loss. Hopefully, you will be able to maintain sales well above the break-even point and generate a reasonable profit. This analysis gives you some insight into the percentage of the market you have to capture. You can then gain a better understanding of the probable risks to be faced by your new business when entering the market. As the percentage of required market capture increases, the risk of failure to meet the requirement increases. In some cases such an analysis might indicate that a more modest initial programme would be desirable, or that a very much larger amount of money should be provided as a cushion to meet unexpected, but perhaps inevitable, difficulties in trying to obtain a large percentage of the market. Of course, some new businesses have natural advantages of distance from competitors in serving local market needs, or an ability to provide much better service. Such factors protect them from competitive retaliation by those already in the market place.

CONCLUSION

This outline of the information to present to a term lender is rather imposing, but you can call on your accountant and the term lender to help you prepare it. Naturally, if the risk is small in amount the analysis need be in far less depth than for a large loan. The

depth of the analysis would also depend on the complexity of your business organization, the risk inherent in the particular industry and many other features. However, the lender cannot make a valid decision on a term loan without considering all these features to some degree. Furthermore, if you have a small to medium-size business, where management control is effectively in your hands, or those of a very small number of individuals, this review of your expansion project with a lender can be valuable to you. It can reduce the risk of some significant error or oversight in your plan and strengthen your chances for success.

For further information that may assist you in managing your business we refer you to the other pamphlets in this series, including F.B.D.B. Pamphlet No. 1 "Reference Booklets for Small Business". Sample copies of these booklets may be seen at all F.B.D.B. offices across Canada.

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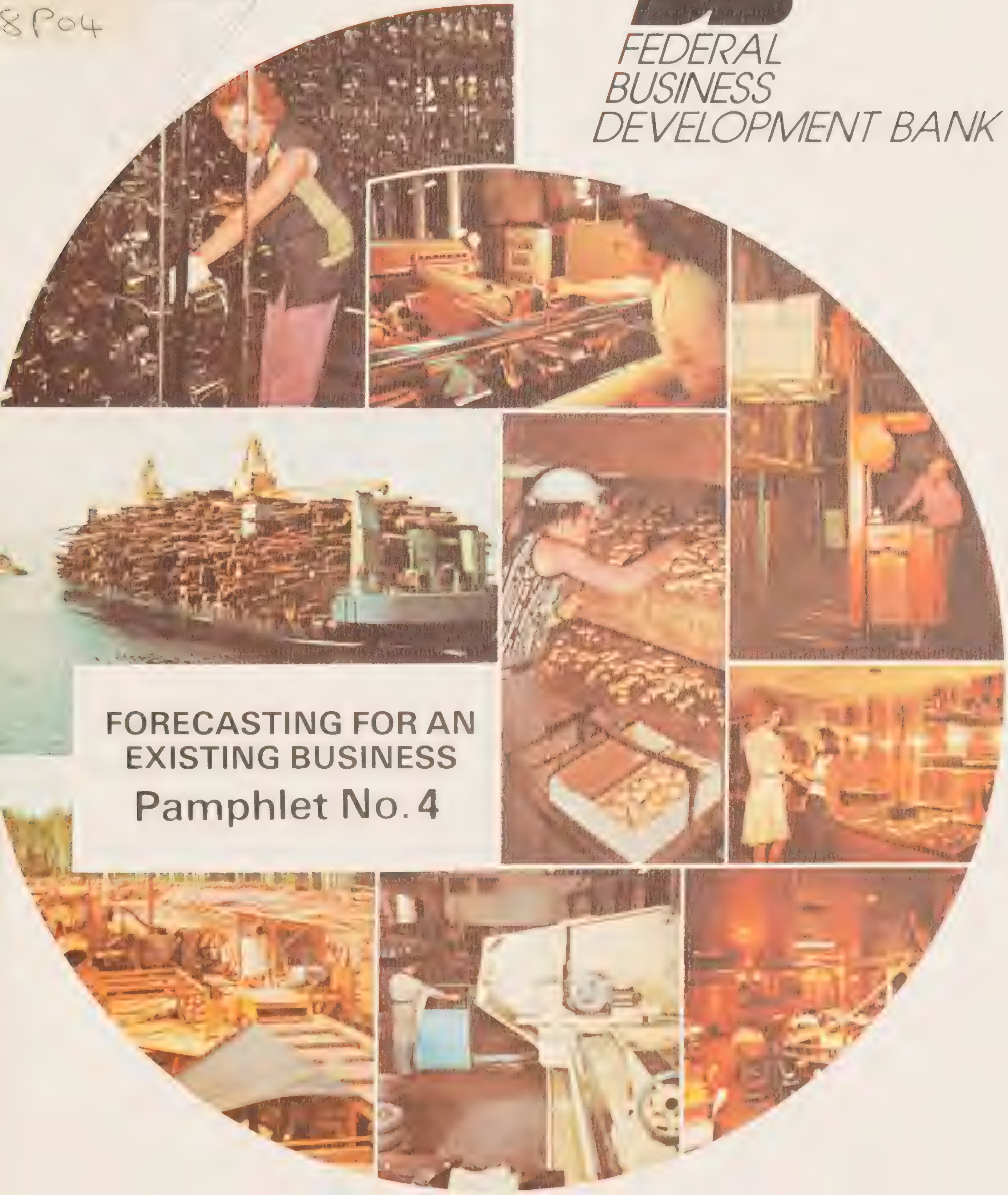

FORECASTING FOR AN EXISTING BUSINESS

Pamphlet No. 4

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FORECASTING FOR AN EXISTING BUSINESS

Pamphlet No. 4

FEDERAL BUSINESS DEVELOPMENT BANK

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FORECASTING FOR AN EXISTING BUSINESS

If you are considering expanding an existing business, one of the first questions you might ask yourself is: What kind of an operating statement can I expect to see after a year's operations? It is certainly one of the first questions a lender will ask if you need a loan to expand. An operating forecast can also be very useful to a business which really has no thought of expanding in the near future.

WHAT IS IT?

For an existing business, the preparation of an operating forecast gives the owner the opportunity to set down what he expects will happen to his revenues and costs. Generally, an operating forecast is prepared for a one-year period — the year following the year-end of the business' financial statements. This does not mean that operating forecasts should be prepared for only one-year periods. Many businesses find it very useful to prepare a one-year operating forecast and then break it down into shorter periods — say 6 or 3 months, or, to help in longer term planning, preparing forecasts for 4 or 5 years ahead.

WHY DO IT?

Preparing an operating forecast need not be too time-consuming and it does have a number of benefits:

(a) Because an operating forecast for an existing business is based on past experience of the business, it gives you an opportunity to learn more about your business.

(b) Because it gives you an opportunity to study the business' past results in detail, it may disclose opportunities to expand the business which might not be apparent during the hectic day-to-day operations of the business. It may help in planning a smooth expansion of the business. For example: Let's suppose that a motel operator is studying the business' previous operating history. He might find that revenues from his small restaurant had been increasing quite substantially, even though there had not been any noticeable increase in the occupancy rate of the motel itself. The occupancy rate might be his major concern in the normal course of business. He might, therefore, not normally pay too much attention to the restaurant revenues, which might make up only a small portion of total revenues of the business. The increase in restaurant revenues, if extended into the next year and subsequent years, might well cause him to examine the restaurant situation very closely. He might then want to consider expanding the restaurant, both to be sure that motel customers could be fairly certain of getting a meal when they wished to and to take advantage of the response the restaurant received from the general public.

(c) Again because it required study of past experience, preparation of an operating forecast can help in drawing the business operator's attention to expenses which should be watched closely.

(d) Preparing an operating forecast to provide for increased or new expenses and revenues which the owner expects to result from a change in the business' operations will help him in making a decision on the various alternatives that might be available to him. For example, to buy or lease certain assets; to put up a new building or renovate the old

one; to change the variety of products sold or produced and other decisions which will affect the future of the business.

(e) Comparison of a forecast and the results actually experienced may also help in pointing out areas of opportunity or concern. The information about the business' operations that could be obtained from preparing an operating forecast may not, of course, necessarily come only from preparing an operating forecast. However, by encouraging the owner to look ahead, preparation of an operating forecast may help in spotting areas of interest and concern before they become urgent. You might find that in spite of increasing revenues, profits have been actually declining slightly. If this decline in profits continues, the business might be hard put to meet its requirements for purchase or replacement of equipment or to provide for its other requirements. This would likely then cause you to look at expenses to see which of these had shown a tendency to increase and by how much they had increased. You might then be able to look at certain specific expenses to see where the problem lies and what can be done about it to put profits back where you want to see them — GROWING.

WHAT YOU EXPECT; NOT WHAT YOU HOPE

Before starting an operating forecast, you should decide to prepare it on the basis of what the business has done and what your business can reasonably be expected to do, rather than what you hope it will do. Naturally, every businessman hopes that his revenues will grow by "leaps and bounds" and that profits will double or triple over what he has experienced. This is seldom the case. The operating forecast can bring our

hopes for the business "back to earth". This can be done by tying the next year's revenues and expenses into what has gone on in the past, and making reasonable allowances for the revenues and costs that can be expected to occur if past experience holds true. If past experience is not expected to hold true, then there should be a reasonable basis in fact as to why this will not be the case.

HOW TO PREPARE THE FORECAST

In order to prepare an operating forecast, you will need to determine all the changes that you can expect to occur in your business' operating statement. If you are considering a change in the operations of your business, the effect this change may have on the revenues, expenses, and profits of the business can, perhaps, be more readily appreciated if you take the time and effort necessary to prepare a detailed operating projection. Generally, an operating forecast would be based on the most recent operating statement for your business. The forecast would show the changes you expect to occur in revenues and expenses in the following year. Revenues and some expenses might increase or decrease; new expenses might be incurred and other expenses might disappear. An example may be helpful.

Assume that your business operates from leased premises (with, say, a lease involving payments of $300/month with the landlord paying utilities and realty taxes — but not business taxes). You might be thinking of buying or constructing a building of your own. For example, the location of the leased building might not be the best possible for your business if it relies to a great extent on passers-by as its customers.

In preparing your forecast, you might first attempt to determine whether you

could expect the business revenues to increase, by additional space permitting you to carry additional lines. Alternatively, the move to a new location would mean that more customers would be coming into the store. Sales would then increase. Having determined this, you would then have a reasonable idea of what the business' revenues for the next year might be.

It would then be necessary to determine the cost of the goods which you expect to sell during the next year. If the cost of the goods sold has been reasonably consistent in relation to revenues over the past years, the cost of the goods sold could simply be calculated as follows:

1. Assume revenues are expected to amount to $200,000.

2. Assume that cost of goods sold has in each of the past 6 years amounted to 80 per cent of revenues.

3. We can then forecast that the cost of goods sold in the next year would be $160,000 (80 per cent of $200,000 = $160,000). "Cost of goods sold" would in most small businesses include all those costs of the goods purchased for resale by the business and would include the amount the business has to pay suppliers, freight and delivery expenses to the store, etc.

You would then have to determine what changes might occur in other costs of operating the business if a building were to be purchased.

1. You might find that because of the larger store and additional product lines, another clerk would have to be hired.

2. Since you would acquire a depreciable asset, depreciation expense would increase.

3. The business would have to pay utilities and realty taxes which it does not now have to pay according to its lease arrangements.

4. Delivery costs, that is, the cost of delivering goods <u>from</u> the store <u>to</u> customers would likely increase as revenues increase.

5. Insurance costs would increase since you would have to insure the building and the increased inventory which you may now be able to stock.

6. If you have to borrow money to buy or construct the building, interest costs would increase.

7. The business would no longer have to pay rent.

8. If the business gives credit, increased volume may mean increased accounts receivable which may in turn mean increased bad debt losses.

Attached are a hypothetical operating statement for this business for the year ended December 31, 1971 (Appendix A) and an operating forecast showing what the owner expects to see in his operating statement for the year ended December 31, 1972 (Appendix B).

With this kind of basic analysis, the operating forecast becomes one of the most useful tools the businessman has in planning the future course of his business and determining which, of many possible alternatives, he should choose.

Appendix A

Operating Statement for the Year Ending December 31, 1971.

Revenues		$150,000
Expenses:		
Cost of goods sold	120,000	
Wages — to part-time clerks	7,000	
Overhead — included in rental payment of $300/month	nil	
Depreciation — on fixtures and equipment	500	
Delivery expenses — delivery from store to customers	2,000	
Telephone	200	
Interest	200	
Insurance — on inventories, equipment, etc.	175	
Advertising	1,500	
Delivery vehicle repairs	150	
Bad debt expenses	200	
Rent — $300/month	3,600	
Business taxes	200	
Realty taxes — included in rental payments of $300/month	nil	
	135,725	
Plus: Cash withdrawn from the business by the owners	7,000	
Total expenses and owners' withdrawals		142,725
Net Profit		$ 7,275

Appendix B

Forecast Operating Statement for the Year Ending December 31, 1972.

Assuming: Land and building are purchased for $20,000 and a term loan of $20,000 is arranged at an interest rate of 9 per cent.

Revenues		$200,000
Expenses:		
Cost of goods sold — 80 per cent of revenues	160,000	
Wages to part-time clerks (assume you find that because of the lay-out of the new building, no additional clerks will be required)	7,000	
Overhead — which the business will now have to pay	800	
Depreciation — on fixtures & equipment	500	
Depreciation — on the building (assume the land, which is not depreciable, cost $5,000, and the building cost $15,000)	750	
Delivery expenses—expected to increase as a result of increased sales	2,500	
Rent — will no longer be paid	nil	
Telephone expense	200	
Interest expense — increased because of interest on term loan	2,000	
Advertising expense	1,500	
Delivery vehicle repairs (increased because vehicles are becoming older)	250	
Insurance — increased because building and larger inventories must now be insured	300	
Bad debt expenses — increased because of increased credit being given	300	
Business taxes	200	
Realty taxes — which the business will now have to pay since it will own the property	800	
	177,100	
Plus: Cash withdrawn from the business by the owners	8,000	
Total expenses and owners' withdrawals		185,100
Net Profit		$ 14,900

CASE

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The Federal Business Development Bank's Management Counselling Services known as CASE (Counselling Assistance to Small Enterprises) assists small businesses in Canada to improve their methods of doing business.

Virtually any established business or anyone about to engage in a business enterprise can apply provided it has had prior discussion of its needs with its appropriate business advisor(s), and provided it has no more than seventy-five employees.

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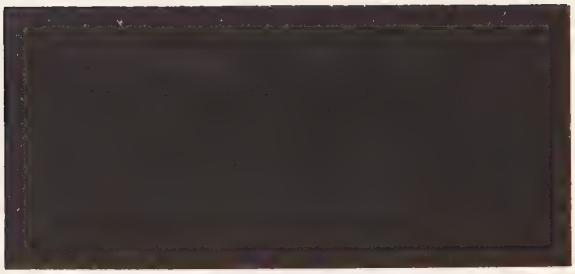
MANAGING YOUR CURRENT ASSETS
Pamphlet No. 5



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MANAGING YOUR CURRENT ASSETS

Pamphlet No. 5

FEDERAL BUSINESS DEVELOPMENT BANK

P.O. BOX 6021, MONTREAL, QUE. H3C 3C3

MANAGING YOUR CURRENT ASSETS

If you manage your own business, or are thinking about doing so, it is important to know how to handle current assets. The left side of your balance sheet shows the assets of the business, that is, the things your business owns, such as inventories, and things owed to it by others, such as accounts receivable. They are divided into categories, the main ones being current assets and fixed assets. How much of your investment should be in current assets? In a small business this means simply how much cash, accounts receivable and inventories does your business need — to start with, during your busy and quiet seasons, and when you are expanding.

Current assets are cash and things that can be converted to cash in the near future, usually within twelve months. They are listed on your balance sheet in the order of how close they are to cash, starting with cash itself, as in the following example:

Small Enterprises Ltd.
Balance Sheet — December 31, 1971

ASSETS		LIABILITIES	
Cash on hand	$ 200	Bank loan	$4,000
Cash in bank	2,000	Accounts payable	2,000
Canada Savings Bonds	1,000		
Accounts receivable	5,500		
Inventories	7,000		
Total Current Assets	$15,700	Total Current Liabilities	$6,000

Let us suppose that this business is selling about $5,000 of goods or services per month during the winter. Is it managing its current assets effectively?

CASH

Most small businesses need a petty cash fund to take care of minor items that arise on a day-to-day basis. So there is no real quarrel with the $200 "cash on hand". The amount should be kept as small as possible, though, so a minimum of money is sitting

idle, not generating a return on the investment.

The $2,000 "cash in bank" looks unnecessary for normal operation of the business. The company is receiving bank credit, and unless this relatively large deposit was needed for a special purpose at the balance sheet date, it seems unjustified. Similarly the investment in Canada Savings Bonds might better be employed in financing the operation of the business.

ACCOUNTS RECEIVABLE

F.B.D.B. Pamphlet No.2 "Giving Credit to Your Customers" outlines briefly some of the principles of a credit system for a small business. The amount of your accounts receivable, the amount owed to your business by customers for goods or services you sold them on credit, will depend to a large extent on the rules you have set up for granting credit to your customers and the way you apply them. If your credit terms are vague and your invoicing system sluggish, your accounts receivable will tie up too much of your investment. This costs your business money.

There are a couple of simple ways of keeping an eye on your accounts receivable. One is to "age" them, that is to classify them according to their age since the date of sale. In the case of Small Enterprises Ltd., an aging of the $5,500 accounts receivable at December 31st, 1971 shows the following:

	$	%
Receivables outstanding less than 30 days	$4,400	80
Receivables outstanding 30 to 60 days	770	14
Receivables outstanding over 60 days	330	6
	$5,500	100 %

If the selling terms of this business are net 30 days, 20 per cent of its receivables are overdue. If these overdue accounts didn't exist, the $1,100 tied up in them could be put to use in producing more goods or services for sale.

The aging analysis, made up from a listing of all your individual accounts receivable, can be done quite quickly on a regular basis, for example at the end of each week or month. If you know your customers, you will also know from the aging analysis what "quality" the overdue accounts have, that is, what likelihood there is of collecting

each, or whether a bad debt loss might be expected from some.

You can also see from examining the accounts receivable whether any overdue amounts comprise mainly one or two large accounts. Just ask your bookkeeper to list separately the accounts overdue in amounts of more than, say, $100 or an appropriate amount that is "large" for your business. In the above example, it might be that the $330 outstanding over 60 days is all due from one customer. If steps to collect from this one customer were applied successfully, the accounts receivable picture would improve sharply.

You can also follow, from the aging schedules for several consecutive periods, whether your collections are improving or whether old accounts are piling up. This might suggest a need for changing your credit terms and collection practices.

If your credit and collection system is under control, the level of your accounts receivable will likely vary directly with sales volume. Another simple test is to calculate the average collection period. If Small Enterprises Ltd. had sales of $75,000 in 1971, the accounts receivable of $5,500 at the end of that year represent about 27 days sales $\frac{(\$5{,}500}{(\$75{,}000}$ x 365 days). The average collection period is therefore 27 days. It would be even more accurate to calculate the average collection period by using the average of the accounts receivable at the beginning and at the end of the year. Also, the calculation could be based on business days in the year, rather than calendar days. This involves a bit more work and the main point is to do it the same way each time.

The average collection period can also be calculated on a monthly basis, each month-end. If December 1971 was a slow month for Small Enterprises Ltd., with sales of only $5,000, the accounts receivable of $5,500 at the month-end were 34 days sales $\frac{(\$5{,}500}{(\$5{,}000}$ x 31). This is higher than the year's average collection period of 27 days' sales, and might be an indication of a slow-down in collections. If so, steps should be taken to urge more prompt payment by customers. On the other hand, it could be that the business normally gives more credit in December than at other times of the year. The circumstances will indicate what collection steps, if any, are required and care should be taken to achieve the best results with a minimum of offence to customers.

INVENTORIES

To control your investment in inventories you need to know regularly what quantities of materials, supplies and finished goods your business requires in stock and what value to give to them. The inventory of a manufacturing business will normally include raw materials, goods in process, finished goods, parts, and supplies, such as the packaging materials for the finished products. In non-manufacturing businesses the inventory may consist of supplies or finished goods, or both.

Consider first the size of inventory required. It is common practice in many businesses to take a physical count of the entire inventory at the end of each business month. This tells you how much inventory you actually have. But how much should you have for good control of your investment?

Generally speaking the smaller the inventory you can carry, and still not run into shortages and slow deliveries to customers, the better. So you should know how fast your finished goods inventory moves out of your business to your customers, that is, how fast it "turns over". Unfortunately, most businesses cannot stock their products just to meet firm orders. They have to have additional goods on hand at all times. Your customers expect you to supply exactly what they want when they need it, or they will buy elsewhere. A complete inventory is needed, including fast-moving and some slow-moving items, but your business should not be overburdened with the latter. If you know where you can get some of these items quickly, perhaps in one day's delivery, you may not need to stock them. You should also know what minimum and maximum inventories you need for your slow and busy sales seasons.

Small Enterprises Ltd. is a manufacturer, and $2,800 of its year-end inventory of $7,000 was raw materials. This amounted to about 17 days sales, with December sales of $5,000. January sales were expected to be the same. The company had found from experience that "17 days' sales" was an adequate inventory of raw materials to keep its production running on schedule. Alternatively, the company could compare its inventory with its purchases rather than sales, and express the inventory as so many

days' purchases. It forecast its sales and corresponding material purchases for each month of the coming year and bought its raw materials in advance accordingly. For a month in which $8,000 sales were forecast it would increase its raw materials level to about $4,500, 17 days' sales. This requires a close watch on purchasing, familiarity with delivery times, price changes and discounts available.

Small Enterprises Ltd. had a goods-in-process inventory valued at $200 at December 31st, 1971. This was the value of the partly-finished products in the plant at the end of that day. In some circumstances this can be reduced by speeding up the plant either mechanically or by using more labour, or by improving the scheduling of production.

This company had finished goods worth $4,000 at December 31st. There were ten different products and each item was recorded on a card showing the quantity on hand, its value and the "re-order point". When the quantity was reduced to this re-order amount, the company would produce or re-order that product. Inventory control systems are described in many readily-available publications, including "Controlling Inventory in Small Wholesale Firms", listed in F.B.D.B. Pamphlet No. 1.

In many businesses, such as this one, a small percentage of the inventory items account for a large percentage of sales. Small Enterprises Ltd. found its breakdown to be:

Products	% of Inventory	% of Sales
1 and 2	20	75
3, 4 and 5	30	15
6 to 10 inclusive	50	10

Obviously, products 1 and 2, the fast movers, should receive close attention in the inventory as they account for 75 per cent of the company's sales. The finished goods inventory can be reduced if more firm orders are obtained, and production is scheduled for their immediate delivery.

For an overall rough check on the size of your inventory another simple calculation, done regularly, is quite useful. Compare your total inventory, all categories, with your average monthly sales for the past several months, say six months. Small Enterprises Ltd. had the following sales for the last half of 1971 :

July	$ 8,000
August	8,000
September	7,000
October	6,000
November	5,000
December	5,000
6 Months Total Sales	$39,000
Average Monthly Sales	$ 6,500

The total inventory of $7,000 at December 31st was therefore about 32 days average sales. The company had found that a total inventory of about 30 days average sales was sufficient for normal operations and had gradually reduced it for the fall and winter, its slack season. It would continue to reduce it to about $6,500.

So much for the quantities of inventory required by a business. How do you price the quantities? A simple method is to price each item at cost or market value, whichever is lower. This avoids overstating the value of your inventory in the event of a decline in the selling price of certain items.

In pricing the finished goods inventory in some businesses, certain items may also lose all or part of their value because of spoilage, a sharp change in fashions, or other factors.

EXPANDING YOUR BUSINESS

If the sales of your business are increasing sharply, or if you plan an expansion to increase your sales, you should also plan what current assets your business will have at the new sales volume. Generally speaking, your accounts receivable and inventories

will increase, but normally you would not need more cash on hand or on deposit.

Small Enterprises Ltd. had sales of $75,000 in 1971, 20 per cent more than its volume of $62,500 the year before. It had studied its orders and markets carefully and forecast sales of $90,000 in 1972, another 20 per cent increase. This would be more than the plant could produce unless it added another machine early in 1972. The company decided to buy the machine and it would be in production in March. What investment would it need in current assets at this higher level of sales?

"Cash on hand" of $200 could be maintained but the $2,000 "cash in bank" and $1,000 Canada Savings Bond could be spent on new materials and supplies. Accounts receivable would be expected to increase to $6,650, still averaging 27 days' sales at the new sales volume, i.e., ($\frac{27}{365}$ x $90,000).

Based on the past, the average raw material inventory should be increased to about $4,200, or 17 days' sales ($\frac{17}{365}$ x $90,000). Its goods-in-process would likely increase due to the additional machine to perhaps $240. Similarly, 20 per cent more finished goods, i.e., $4,800 on the average, might be needed to fill the additional orders, although this would depend on the new higher production rate and the proportions of items being sold. This would mean a total inventory of $9,240, rather than the former level of $7,000.

In summary, the old and new levels of inventory would be as follows:

	1971 Sales $75,000	1972 Sales $90,000
Raw materials	$ 2,800	$ 4,200
Goods in process	200	240
Finished goods	4,000	4,800
Total Inventory	$ 7,000	$ 9,240

The current part of the company's balance sheet might look like this during the next peak sales period, say June 30, 1972.

Small Enterprises Ltd.
Balance Sheet — June 30, 1972

ASSETS		LIABILITIES	
Cash on hand	$ 200	Bank Loan	$3,000
Accounts receivable	6,650	Accounts payable	2,400
Inventories	9,240		
Total Current Assets	$16,090	Total Current Liabilities	$5,400

CONCLUSION

A few simple checks — aging of receivables, calculating the collection period, and analysing the inventory by size and products — can guide you in managing your current assets. If done regularly, they can help you to keep your investment in current assets down to a level your business can afford. This means your money is being used where it is most needed and some will be available for the other main category of assets, fixed assets.

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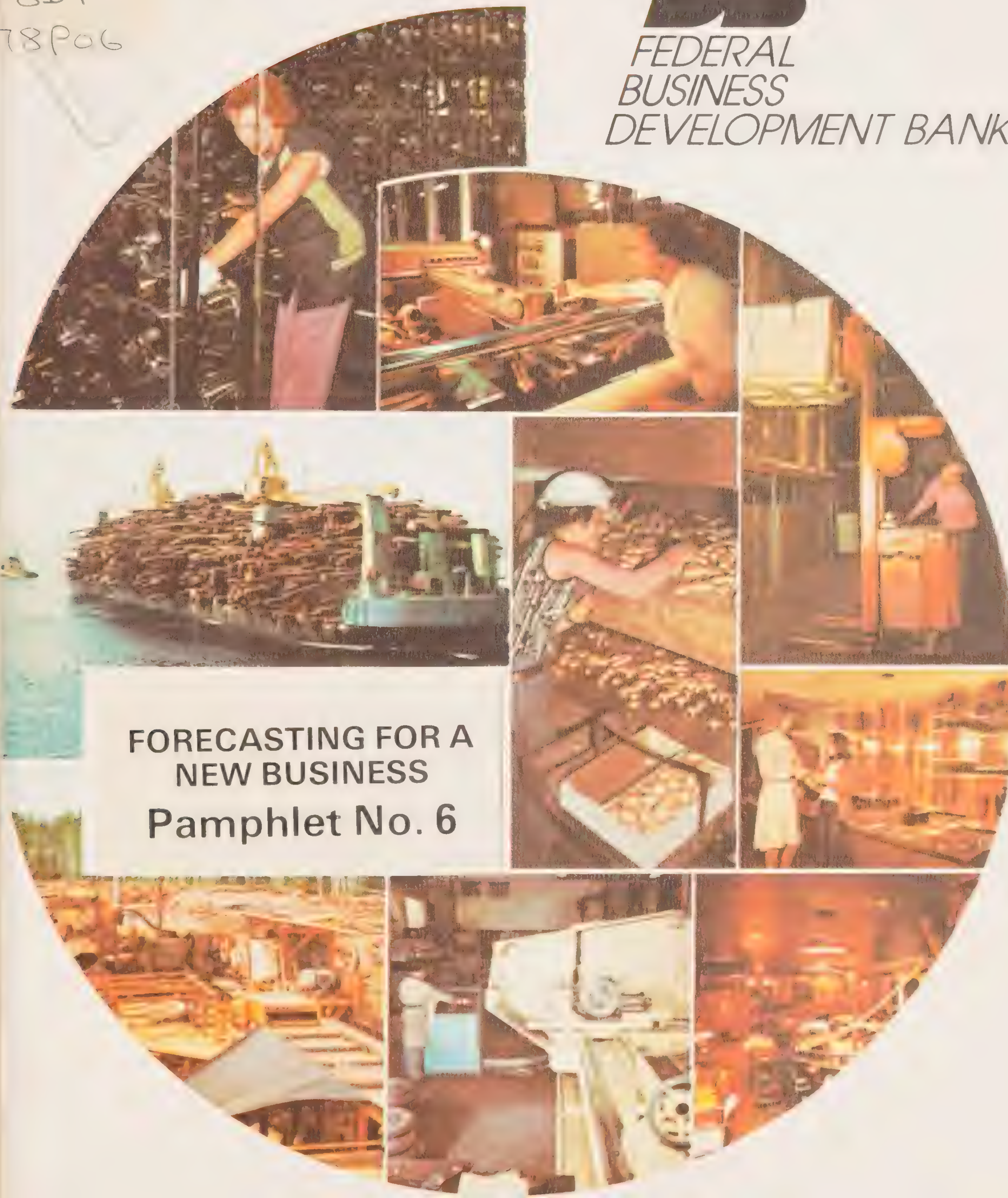

FORECASTING FOR A NEW BUSINESS

Pamphlet No. 6

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FORECASTING FOR A NEW BUSINESS

Pamphlet No. 6

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FORECASTING FOR A NEW BUSINESS

WHY FORECAST?

As mentioned in F.B.D.B. Pamphlet No. 4 "Forecasting for an Existing Business", careful preparation of an operating forecast is one of the most useful and meaningful tools available to a businessman. It can help you to spot opportunities, and to learn more about your business. It might also point out things about your business which could cause financial difficulty if left untended for a lengthy period. The results (revenues, profits, etc.) of the business' operations as shown by the operating statement, will have direct bearing on the business' balance sheet and, of course, on its future.

An operating forecast can be described as the operating statement which a businessman would expect to see for his business at the end of the period for which the forecast is being prepared. Generally, this period would be a year. For a new business, the forecast would show what revenues and expenses you expect the business to experience in its first year of operation. It can be very useful, of course, to prepare a forecast for a longer period than one year. But preparation of the first year's operating forecast is one of the first steps taken in planning the establishment of a new business.

THE EXISTING BUSINESS AND THE NEW BUSINESS

If the operations of an existing business undergo a slight change, there is generally enough similarity before and after the change to make past experience meaningful for the future. In some ways, then, preparing an operating forecast for an existing business may be less challenging than preparing one for a new business.

In the case of a new business, there is no historical record to go by. For this reason, preparation of an operating forecast for a new business can be an interesting and rewarding experience, even though time and effort will be required.

GUIDELINES AND THE FORECAST

You can sometimes obtain guidelines on revenues and costs for a particular type of business from magazines and periodicals or firms engaged in the type of business you are considering. By reading a lot and talking to many people you could develop a forecast of revenues and costs which might seem to be entirely reasonable. However, as is pointed out in most articles on the subject, an operating forecast for a new business cannot be divorced from the location of the business; the type of product it sells; the market the business serves; the physical facilities and the actual capabilities of the owners and employees. Guidelines are just that; individual circumstances will determine their relevance.

BE SURE OF YOUR SOURCES

If you were to hear a statement like "The average annual profit of businesses at Kumquat is $40,000" your first reaction might be "Kumquat, here I come!". Only after further questioning might you find out that this figure includes the large profits of, say, a major mining company and the more modest profits of many other businesses. The vital point to remember is that "averages" and other statistical information sometimes can be meaningless. In order to make such information meaningful it is important that you know the basis on which the information being "averaged" was prepared. It is also important that you know what information is meant to be conveyed by the statistics you are using. Statistics Canada's booklet "How to Profit from Facts" provides interesting examples of how statistical information can be utilized and some helpful advice on how to use Statistics Canada's services.

DON'T THROW AWAY YOUR MONEY

If you are going to put your life's savings into starting a business, you certainly don't intend to lose this investment because the business fails. You expect the business

to make reasonable profits and give a return on your investment. You may consider the opportunity "to be your own boss" to be part of this return. Or you may be interested in making substantial profits. Either way, you will want to obtain some indication of the business' chances of providing the return you wish. It is therefore important that the future of the business be considered very closely before you invest your money in it. Even if it means spending a few dollars on postage or taking up time you could be spending doing something else, an investment in a carefully prepared operating forecast can mean a difference of many times that amount in profits for your business or the saving of an investment that would otherwise be lost.

THE OPERATING FORECAST - NOT A "MAGIC POTION"

Even after you have considered the whole matter quite exhaustively, you will likely find "iffy" areas remaining in your forecast. This will be so with many small businesses, especially those that involve new technological developments or new products. Even so, information obtained in preparing an operating forecast can eliminate some of the areas of uncertainty which can cause a business' quick failure if it is established with a "Damn the torpedoes!" approach. All too frequently, the business established with this approach does not fail because of a single catastrophic event. Rather, it slips away into quicksand and will not only disappear itself, but will cause "close calls" or equally unceremonious deaths for some of the other businesses which have supported it, for instance those giving it credit.

There will likely always be business failures, from a number of causes, and preparation of an operating forecast will not eliminate the risks of failure. Rather, the forecast can provide some further insight into the possible risks involved and a more informed basis on which to judge them. It can reduce the number of surprises that might lie ahead for your business.

PREPARING THE FORECAST:

As was stated earlier, an operating forecast can be described as the operating statement which a businessman would expect to see at the end of the period for which the forecast is prepared. An operating statement might have the following form:

OPERATING STATEMENT — XYZ CO.

REVENUES —		______
EXPENSES		
Material cost (the cost to you of goods which you expect to sell during the year)	______	
Wages and benefits	______	
Depreciation	______	
Overhead (light, power, heat & water)	______	
Equipment repairs	______	
Delivery expenses	______	
Advertising	______	
Insurance & taxes	______	
Rent	______	
Interest	______	
Cash withdrawals by owners	______	
Total expenses & cash withdrawals		______
Net Profit		______

You would then want to fill in whatever amounts you would expect to see opposite these items for a year's operation after your project is completed. It may be, of course, that some of the above headings would not be suitable for your kind of business, or that others should be added, but the above example illustrates how you should proceed in setting up an operating forecast.

MAJOR ITEMS TO BE CONSIDERED

The following questions are only some of those which you will want answered in establishing a new business:

The Market:

1. Who will your customers be? The type of business you are considering will, in part, determine the answer to this question. If you are thinking of a fishing camp, your market will be the angler. If you want to make widgets, you would need to know who uses them. In the case of the widget manufacturer, for example, additional questions arise from the initial question:

(a) Is the market for widgets growing or contracting?

(b) If your widget is superior in say, wearing qualities, a further question might be: "Will a longer-wearing widget be attractive to these customers?" The longer-wearing widget may be of interest to the users. On the other hand, though, you might find that your possible customers are not interested in a longer-wearing widget, more expensive than those they now use, because the existing type of widget lasts as long as the equipment in which it is used. It might not make sense for prospective customers to purchase a product they do ı really need.

(c) Where are the customers located? This may affect your decision on location of the business; advertising; how many salesmen to employ.

(d) How do the customers order? Regularly or irregularly? In a few large orders or several small ones? What is the frequency of "rush" orders? Answers to these questions will affect your inventory requirements, the scheduling of production and possibly the number of employees you will require.

2. Prices:

What are the prices of competitive products? Do these prices include freight costs? Are discounts given by competitive businesses? What price structure do you need in order to make reasonable profits?

3. Material:

What will be the cost of the materials you need? How well established are your suppliers? What is their reputation for quality, service and delivery?

4. Competition:

Who are your competitors? Are they large or small companies? How are they likely to respond to your company's entry into the widget-making business? Are they likely to cut prices of their own product, improve service or develop their own longer-lasting widget in response to your possible threat to their business? How long might it take them to develop such a widget? In other words, how much time do you have to become an established widget supplier? Could you still compete effectively if competitors were to "take a run" at you? Can they afford to do so? How many widgets can you sell and at what price?

5. Facilities and Equipment:

What kind of facilities do you need? What are the costs of facilities and equipment? What are the relative costs of leasing and purchasing facilities and equipment? Is adequate equipment available? When, and under what conditions (warranty, delivery, etc.) can it be obtained? What are the reputations of the various manufacturers of the equipment?

6. Employees:

What skills will your employees need? If you have decided on a location where you would prefer to establish your business, is there an adequate

supply of possible employees with the skills you need? Can these skills be readily taught? Is there a training facility in the area or will you have to do the training yourself? What wage rates and benefits will you have to pay? What relationship do other businesses in the area have with their employees? Will you pay by the hour or on some other basis, for example, piecework?

7. Production Costs:

How much will the material to make a widget cost? Is there any difference in material costs for different numbers of widgets produced? What will power cost and how much will be needed to operate your equipment, and heat and light your facilities? How many widgets can an employee produce? How many widgets do you need each employee to produce to sell the volume expected? What regulatory authorities will you have to deal with? What are the regulations you will have to obey? What, if anything, will adherence to these regulations cost?

8. Financial:

What kind of record-keeping system should you have? Will you need a bookkeeper? a full-time accountant? If you need to borrow money, can it be obtained? On what terms?

9. Working Capital:

What inventory level will you need in raw materials? — finished product? What is the amount of accounts receivable you can expect to have on your books at any one time? What payment terms would apply? What are the payment terms of your suppliers? How long would it take for the purchased material to be sold as finished product? What proportion of your sales would be for cash or immediate payment? Is working capital support available if you need it?

This is by no means a complete list of the questions you will want answered if you are thinking of starting a new business, but it may give you an idea of the type of question that will occur. Plainly, they will only be answered after considerable effort. Your accountant, your banker, the Industrial Commissioner, the Board of Trade and various government offices may be able to help you.

When you have obtained the information you need, an operating forecast such as the one shown, could be constructed.

Operating Forecast — XYZ Widget Co. for the Year Ending Dec. 31, 1972

Revenues:	1,000,000 widgets at 6½¢ each		$65,000
Expenses:			
Material at $0.03/widget		$ 30,000	
Wages & benefits, 3 employees at $5,000 per year		15,000	
Depreciation (on equipment costing $5,000)		1,000	
Overhead (Power, light, heat & water)		2,000	
Equipment repairs		500	
Delivery expenses		1,000	
Advertising		500	
Insurance & taxes		300	
Rent		2,400	
Interest		200	
		$ 52,900	
Plus: Cash withdrawals from the business by the owner		7,000	59,900
Net Profit:			$ 5,100

If the owner of the XYZ Widget Co. has obtained accurate information, he will already be provided with answers to many of the problems which might otherwise cause the business early difficulties. These problems could arise very quickly if he had simply been determined to "have my own business" and simply trusted in luck or his own capabilities to surmount them. While XYZ's success would not be guaranteed, its chances of success would be good because the owner was prepared not only to work hard at the business but, more important, was prepared to think hard about it.

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MANAGING YOUR FIXED ASSETS

Pamphlet No. 7

[redacted]

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MANAGING YOUR FIXED ASSETS

Pamphlet No. 7

FEDERAL BUSINESS DEVELOPMENT BANK
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MANAGING YOUR FIXED ASSETS

As a rule, some of the money you put into your small business is used to buy fixed assets. These are things that are needed to operate your business, but they are not bought for the purpose of selling them as products. Some of the most common examples of fixed assets are land, buildings, machinery, equipment, vehicles and furniture. They do not get used up, or consumed, in the same way as the materials used to produce the products or services for sale, but a part of their useful life goes into the production of each of your products or services. They can be expected to lose value as they wear out, or break or burn, or deteriorate in some way during their lifetime — all except land. Land does not depreciate, although in special cases, such as land containing mineral reserves, the underground value may become exhausted or "depleted".

Knowing what fixed assets you need, and how to look after them, will help you make the best use of your money in the business.

In F.B.D.B. Pamphlet No. 5 "Managing Your Current Assets" it is pointed out that current assets are listed on the left side of your balance sheet in the order of how close they are to cash, starting with cash itself. Fixed assets are also listed on the left side of your balance sheet, below the current assets, usually in the order of their expected useful life.

Assets with the longest expected life are listed first, for example:

Land	$ 2,000
Buildings	20,000
Furniture and fixtures	2,000
Machinery	10,000
Vehicles	3,500

The value shown initially on the balance sheet for each type of fixed asset is normally the cost, that is the original price paid by the business. However, every year it is normal practice to reduce the "book value" of each fixed asset, i.e. the value shown on the balance sheet, by subtracting an amount for the "wearing out" that has occurred during the year, except for land. The amount is charged as an expense to the business for the year and is shown on the profit and loss statement for the year as "depreciation

expense'' or ''depletion allowance''.

There are various methods of calculating depreciation of fixed assets, but a full discussion of the subject is beyond the scope of this pamphlet. It is required that you use one method, ''the diminishing balance method'', to calculate the income tax payable by your business. This simply means that you reduce the book value of each fixed asset by a fixed percentage each year. The federal Income Tax Act stipulates what maximum percentage of book value you can charge as a tax-exempt business expense for each type of fixed asset. By this method the amount of depreciation charged keeps reducing year by year as the book value reduces each year.

Many businesses prefer to use other methods for their own records, even though they are still required to calculate their income tax separately, using the diminishing balance method. One of the simplest and most commonly used is ''the straight-line method''. By this method, it is assumed that the same amount of depreciation occurs during each year of the useful life of a fixed asset. If a new machine costing $1,000 is expected to be used for ten years, and to have a salvage value of zero after that time, $100 of depreciation would be charged in each of the years used.

On the balance sheet, these yearly charges for depreciation are accumulated as follows:

		Book Value after Accumulated Depreciation
Land		2,000
Buildings	$ 20,000	
Less Accumulated Depreciation	2,000	18,000
Furniture and fixtures	2,000	
Less Accumulated Depreciation	200	1,800
Machinery and equipment	10,000	
Less Accumulated Depreciation	2,000	8,000
Vehicles	3,500	
Less Accumulated Depreciation	1,050	2,450

IVORY TOWER OR RAIN SHELTER

In estimating and planning what fixed assets are required for your business, the ideal is to avoid buying too much and too fancy, as well as too little and too austere. For a new business particularly, it is often advisable to rent a suitable building, if available on reasonable terms. Later, when the business is well established, when its building requirements are known more precisely and it is in a better position to repay a term loan, the purchase of a building may be more justifiable. Buildings don't produce profits in most types of businesses. They merely provide shelter for the employees and machines which do. There are important exceptions of course, such as the hotel-motel industry, where buildings house the customers. In such cases, attractive, comfortable buildings are needed right at the start.

Requirements for machinery and equipment can often be reduced also by contracting certain work out to other firms, or by leasing. Perhaps certain parts of your products can be made by others for final assembly at your plant.

Another consideration is whether suitable second-hand assets could be purchased. Even large companies often shop around for used machinery and other fixed assets to fill certain of their needs. These may cost more to operate, but less to finance.

LAND

The initial price is only one consideration when you are looking for land for your business location. Where is your market? Where do you get your materials and labour? Is the shape of the site suitable for your building and operation? Is there good access to it? Is it completely serviced? What are the taxes? Are there any zoning or other restrictions about building? Is parking space adequate? Such considerations may be more important to the long-term success of your business than the initial price of land.

No matter what location you select, don't forget about future expansion. If the sales of your business increase 10 per cent per year, they will double about every seven

and a half years. If they increase 15 per cent per year, they will double every five years. This kind of sales growth requires more space and other facilities regularly. Is your land site large enough for such growth, or alternatively, would it be feasible to move the business to a larger site in five or ten years?

BUILDINGS

Before selecting a building for your business, you should give careful thought to the arrangement of the machinery, equipment and work areas inside the building. A careful layout should be made on paper, using moveable blocks of heavy paper representing to scale every major piece of equipment, machinery, etc. in its location in the building. Picture in your mind how the people and materials will move in your building. Then move the ‘‘models’’ around on paper to give you the most efficient layout. This should result in a smooth flow of traffic without too much criss-crossing. It should also provide easy passage of goods into the receiving area and out of the shipping area. If you don’t want to make your own plant layout, hire a consulting engineer to do it for you. But above all, do prepare a layout! Moving a machine on paper ahead of time is much cheaper than moving the actual machine from a bad location later. Why not visit a few buildings used for the same type of business? Study their layouts, and you may benefit from their experience, or from their oversights.

Don’t forget about expansion again, either horizontal, or vertical, or both. If you expect to expand horizontally, your plans might call for a temporary wall on one side, adjoining the vacant land area on which you will expand. If you are thinking of vertical expansion, make sure the building columns are designed to support a future upper storey.

Common-purpose buildings are the most readily saleable, so avoid, if possible, any special features that would detract from the building’s attraction to other businesses. You might want to sell it or rent it sometime. Many standard pre-fabricated buildings are available to suit most purposes. These should be considered versus a custom-designed building.

You will want to consider carefully all of the services that your building will require. Heat, water, electric power, and waste disposal are standard services, of course. You will need to know what type and quantity of each of these services are needed before deciding on the equipment and distribution for your building. You may have to install pollutant controls for your type of business. You may also need air conditioning, refrigeration and special materials-handling equipment such as power conveyors. Suppliers of this equipment will help you select the best size for your purpose.

Choosing a suitable, fully-serviced building is one of the most important business decisions you will have to make. When you have considered all of your requirements in a preliminary way you will be wise to get professional help for the final design, obtaining of a construction contract by tender, and supervision of construction.

As mentioned earlier, the federal Income Tax Act allows you to charge each year, as a business expense which will not be taxed, an amount for the depreciation of your building, if it is owned by your business. Examples of the current maximum depreciation rates in use are 10 per cent per year on frame buildings and 5 per cent per year on brick or masonry buildings. These percentages are applied to the ''book value'' of the building, that is, the cost less the depreciation you have charged to date on the building, using the diminishing balance method.

Suppose you are considering the purchase of a warehouse building. Two new buildings of the same size are available, one of steel frame and brick construction, and the other of wood frame and siding. Which should you buy? There are several methods of comparing, in financial terms, the relative merits of alternative choices of fixed assets, such as buildings. The ''Total Annual Cost'' method is one you could use, and your comparison could take the following form:

	Building A Steel & Brick	Building B Wood
DATA		
Initial cost	$60,000	$ 28,000
Interest rate	9 %	9 %
Depreciation	5 %	10 %
Taxes	4 %	4 %
Fire insurance, annual, per $100		
Building	$1.00	$2.50
Contents (Value $30,000)	$1.25	$3.10
Business loss insurance	$600	$700
Operating cost disadvantage	—	$500
ANNUAL COST		
Interest	$ 5,400	$ 2,520
Depreciation	3,000	2,800
Taxes	2,400	1,120
Fire insurance, building	600	700
contents	375	930
Business loss insurance	600	700
Operating cost disadvantage	—	500
TOTAL ANNUAL COST	$ 12,375	$ 9,270

In this case the wooden building should be purchased because of its lower annual cost.

FURNITURE AND FIXTURES

You and your key employees need comfortable, quiet offices where your brains will function most effectively, and where you can conduct your business in an organized manner. But that should be the prime purpose of offices.

Of course, in some businesses it will be good business to "dress up" your office space, to introduce some artistic appeal, and to display the goods, workmanship and services of your business in an appealing way. In such cases, some extra investment in furniture and fixtures is warranted. But don't overlook the fact that good service is usually a far more compelling force in attracting and keeping customers than luxurious, expensive office furniture.

MACHINERY AND EQUIPMENT

James Watt, who patented one of the first practical steam engines in 1769, said : "Of all things, but proverbially so in mechanics, the supreme excellence is simplicity." This is particularly true of machinery and equipment for a small business, where high initial costs and later maintenance costs for overly-sophisticated items may be prohibitive. In fact such machines may cause excessive stoppages of production, where a simpler version would keep running.

When selecting equipment you need to be specific in what it should do for you. Decide on this in detail, then start shopping. How many units of your product should the machine handle in a given time to meet your sales requirements? How many operators can you afford to run it? How much space is available for it? What quality does it need to be able to produce? There's probably a machine available to meet your basic requirements. So make the machine match your requirements. If you fall in love with a sophisticated machine first, and then try to make your plant match the requirements of the machine, you may waste some of the money you have invested in your business.

If you are manufacturing products, it is your machinery, equipment and employees that will make profits for your business — not land, buildings and furniture. Try to find simple, good quality machinery and equipment at the lowest cost rather than complicated, good quality items at high cost. Even the simple principle of steam power, discovered about 200 B.C., and put to practical use in steam engines by Thomas Newcomen, and then James Watt, over 200 years ago, is still used widely and efficiently in simple machines such as steam turbines for producing electrical power. Counting the beads on an abacus may be too slow for your accounting work. On the other hand, an electronic calculator may be a faster and costlier machine than you really need. A simple manual adding machine might be the best answer for the limited needs of your small business.

Suppose you are considering the purchase of a machine for your business, for example, a power lathe for your machine shop. A common method for analysing such a purchase is the "payback method". Will the savings from the machine pay for the machine before it wears out? A lathe might be available for $4,000 that would last you 8 years and would save you $1,000 in labour each year. The payback period would be $\frac{\$4,000}{\$1,000}$ = 4 years. This sounds attractive because the lathe would pay for itself in much less than its expected useful life. You should probably buy it. But is there a better buy available?

Another supplier will sell you a more versatile lathe for $6,000 that should last 10 years and should save you $1,500 in labour each year. The payback period would be $\frac{\$6,000}{\$1,500}$ = 4 years, the same as the first example, so this one sounds attractive too. Now what do you do to choose between them? Look at the expected useful life of each machine. The $4,000 lathe will pay for itself in 4 years, or 50 per cent of its useful life of 8 years. But the $6,000 lathe will pay for itself in 4 years, only 40 per cent of its useful life of 10 years. So buy the $6,000 machine, which pays for itself relatively sooner in its useful life.

VEHICLES

Does your business need to own vehicles at all? Probably. A car for you at least, and for your salesman, if you have one. Have you considered renting vehicles, particularly if you require one or two new ones all the time for sales purposes? On the other hand, if you need a light delivery truck, you would probably use it for several years and then sell it for scrap or trade it in. Owning, rather than renting, such a vehicle would probably be wise because the average annual cost over its lifetime would be quite low.

Owning vehicles involves your business in two kinds of expenses, "fixed expenses" and "variable expenses". The fixed expenses for a vehicle are those you will have to pay regardless of how much you use the vehicle, even if it is just sitting in your parking lot most of the time. Such things as insurance, license fees, seasonal servicing, and of course depreciation. Generally speaking, the more expensive vehicles have the higher fixed expenses. Variable expenses are those which will vary according to the number of miles a vehicle is driven. Such things as the cost of fuel, oil, tires, spark plugs and other replacement parts. Generally speaking the farther a vehicle is driven, the lower the average variable expenses per mile. And a more expensive vehicle does not necessarily have much higher variable expenses than a cheaper one.

Suppose you are trying to decide between the purchase of a $3,000 car or the purchase of a $5,000 car for your salesman. To help you decide which would best suit the needs of your business, you could compare the main expected fixed and variable expenses for each, assuming for example, that the car might be replaced in three years with a certain trade-in value. The comparison could take the following form:

	Car A Price $3,000	Car B Price $5,000
Replacement period	3 years	3 years
Trade-in value in 3 years(estimated)	$1,500	$2,500
Cash outlay at replacement	$1,500	$2,500
Fixed Expenses - (Average per year)		
Insurance	$ 130	$ 175
License	25	45
Seasonal servicing	25	35
Car washing(20 per year at $1.75)	35	35
Replacement(1/3 of cash outlay at replacement)	500	833
Interest on investment at 7 per cent	210	350
Miscellaneous(battery replacement, parking, etc.)	60	80
Total Fixed Expenses	$ 985	$1,553
Variable Expenses		
Fuel(18 miles/gal. at 45¢ gal.)	$0.025 per mile	$0.025 per mile
Tire replacement(4 tires every 25,000 miles)	* 0.004 " "	0.005 " "
Replacement of oil, oil filters, spark plugs	0.003 " "	0.003 " "
Snow tires(2 at $25 each every 30,000 miles)	0.002 " "	0.002 " "
Replacement of shock absorbers	0.002 " "	0.002 " "
Miscellaneous garage repairs ($100/ 10,000 miles)	0.010 " "	0.010 " "
Total Variable Expenses	$0.046 per mile	$0.047 per mile
	* ($20.00 per tire)	($30.00 per tire)

Summary — Cost of Car Operation per mile

Miles Driven Per Year	Fixed Expenses Per Mile		Variable Expenses Per Mile		Total Expenses Per Mile	
	Car A	Car B	Car A	Car B	Car A	Car B
30,000	$0.033	$0.052	$0.046	$0.047	$0.079	0.099
20,000	0.049	0.078	0.046	0.047	0.095	0.125
15,000	0.066	0.104	0.046	0.047	0.112	0.151
10,000	0.098	0.155	0.046	0.047	0.144	0.202
5,000	0.197	0.311	0.046	0.047	0.243	0.358

The figures used are for illustrative purposes only and you would have to select those applicable to your own situation. They do show, though, that the operating cost at low mileage is very high. At 5000 miles of driving per year, Car A in the example costs about 24 cents per mile, and Car B, the $5,000 model, costs about 36 cents per mile. Car rental rates are well below these figures. The example also shows that at high mileages of 20,000 or 30,000 miles per year, the higher-priced model becomes relatively more attractive, i.e. the cost per mile is not much higher than for the cheaper model. Also, at these higher mileages, car rental rates would be less attractive in comparison. Applying this type of comparison to your own situation should lead you to a prudent decision on the buying or renting of vehicles.

INTANGIBLE ASSETS

The fixed assets discussed so far are tangible fixed assets, that is, they have physical substance. Fixed assets can also be intangible, for example, things used in the operation of the business which do not have physical properties, such as patents or copyrights. The value of such intangible assets is in the rights which their possession gives to your business. Even intangible assets have a limited useful life and their value, or cost, in most cases, may be charged off gradually as a business expense during their estimated useful life. This systematic "write-off" for intangible assets is usually called "amortization". It is a similar idea to "depreciation" for tangible fixed assets (except "natural resource" fixed assets, such as mineral or timber rights, for which the term "depletion" is used).

Some intangible fixed assets may have an indefinite useful life, for example, good will, rights, and franchises without a termination date. These may also be amortized; otherwise they might have the effect of overstating your balance sheet at a later date. Such assets as goodwill have been known to become valueless during the life of a business.

CONCLUSION

The fixed assets of your business are not sold like products or services, but they have a direct bearing on your selling prices. A part of their original value goes into the production of your goods or services during their useful life, except in the case of land.

This "wearing out" of fixed assets, or depreciation, is a business expense. It is an allowable deduction from the income of your business before taxation.

Before choosing fixed assets you should consider not only their cost, but the future expansion needs of your business. Alternatives, such as leasing certain fixed assets, or purchasing used items should also be considered. Emphasis should be put on fixed assets that will produce profits for your business.

Good management of your fixed assets will keep your fixed expenses, such as interest and depreciation, under control and your selling prices competitive.

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MANAGING YOUR CASH

Pamphlet No. 8

[redacted]

MANAGEMENT SERVICES

The Federal Business Development Bank provides financial and management services to new or existing businesses anywhere in Canada, particularly those of smaller size.

Helping to promote sound management practices in small businesses is an objective of the Bank's management services. As part of this program, FBDB is publishing this series of pamphlets. Copies may be obtained in English or French without charge from any FBDB office, or by mail using the Order Form in the back of this pamphlet.

MANAGING YOUR CASH

Pamphlet No. 8

FEDERAL BUSINESS DEVELOPMENT BANK

P.O. BOX 6021, MONTREAL, QUE. H3C 3C3

MANAGING YOUR CASH

Pamphlet No.5 in this series, titled "Managing Your Current Assets" discusses cash as part of the current assets of a business. Accounts receivable and inventories are other current assets which should eventually be turned into cash; then into other assets, used to reduce debts, or withdrawn from the business.

It is not uncommon for businesses to make profits and yet to be in trouble because they don't have the ready cash to pay their current bills. You won't stay in business very long if bills go unpaid, so managing cash is a vitally important part of managing your business.

CASH MANAGEMENT – ITS PURPOSE

The purpose of good cash management is to have enough cash — in the till, in the Bank, or readily available elsewhere — to meet your expenses and bills when they come due. You should not have too much cash, or the resources of the business will not be used as profitably as possible. Surplus cash in the till is doing nothing but sitting there, and may tempt some enterprising fellow to bring your cash supply and demand into closer alignment by relieving you of some of it. He might, of course, be very upset if there's nothing in the till, and would doubtless be unimpressed if you were to tell him that according to your cash flow forecast you really had no need for "till money" until tomorrow.

Cash for your business operation is like many other things — it's better to have too much than too little. But it's better still to have the right amount. The purpose of cash management is to determine as closely as possible just what the right amount is.

HOW TO MANAGE CASH

There are a number of ways you can control the cash which passes through your hands:

a) At the till — till and tape balances should be balanced. Cheques, which you may want to personally approve before they are honoured, should be deposited with your bank as soon as possible.

b) At the "petty cash" box — you will want to ensure that the amount which you have set as a petty cash reserve is always there in either cash or vouchers.

c) At the bank — you will want to reconcile your records and your bank's records of deposits and withdrawals, and provide for cheques which you have issued but which have not yet reached your bank.

These are activities which you would do on a regular basis.

But these are only pieces of the "big picture" — the overall financial position of your business. Your business might have cash of $500 on hand after providing for cheques outstanding, and you might feel reasonably well off. You might have forgotten, however, that a $1,000 note on a piece of equipment comes due next month. The equipment supplier might be a little disturbed if you say you don't have the money to pay him. A fast trip to a lender might result in a loan to pay the supplier, but this can create needless wear and tear on your physique and probably would not give the lender a great deal of faith in your management ability.

Some wear and tear, and possibly some sleepless nights, can be avoided if, by preparing a cash flow forecast, you have a reasonably good idea of what cash you will need, and when and from where it is coming.

THE CASH FLOW STATEMENT VS THE STATEMENT OF PROFIT AND LOSS (OPERATING STATEMENT)

There is a basic distinction to be made between a cash flow statement or forecast and the statement of profit and loss (operating statement) or operating forecast. The cash flow statement shows all **cash receipts** from every source as they are **received** and all **cash payments** by the business as they are **made**. The operating statement shows **sales** and **expenses** as they **occur** but in certain cases before cash has actually been received or paid; it does not show changes in the business' cash position; and does not necessarily show all cash transactions.

While instances of some of these differences will be given later in this pamphlet, the following example will show a major distinction between these two financial tools:

> If you sell $100 worth of goods on March 15th and receive payment in cash at the time of sale, the $100 would appear as a sale on your profit and loss statement for March and would also be a cash receipt on your cash flow statement for March.
>
> However, if you sell $100 worth of goods on March 15th on 30-day terms and collect the $100 on April 15, this would appear as a sale on your March profit and loss statement but would not appear as a cash receipt on your cash flow statement until April.

BASICS OF THE CASH FLOW FORECAST

Basically the cash flow forecast or cash flow budget simply sets out the business' expected timing and amounts of cash income and cash payments; that is, the cash flow through the business. This is sometimes referred to as the "receipts and disbursement" method of cash flow forecasting.

Let's take, for example, the case of a tourist camp operator, the Big North Tourist Camp, and assume the following:

1. His customers all pay him in cash.
2. He makes all his payments in cash.

Assume also that he has been in operation for a year, 1972, and then went back through his records for 1972 to see what his cash flow had been. If he started the year with $500 cash on hand and in the bank, the cash flow statement for the year might look like this:

Cash balance — January 1, 1972	$ 500
Cash in — January 1 to December 31, 1972	25,000
Cash out — January 1 to December 31, 1972	22,000
Cash balance — January 1, 1973	3,500

This shows a $3,000 increase in cash within a year, but among other things, it doesn't tell us where the money came from, or where cash was spent. The business' financial statements would tell us this.

Let's suppose, though, that this tourist camp operator wants to know what the business' cash flow position looked like on a monthly basis for the past year:

CASH FLOW STATEMENT – BIG NORTH TOURIST CAMP

January, 1972 to December, 1972

	JAN. 1972	FEB. 1972	MAR. 1972	APR. 1972	MAY 1972	JUNE 1972	JULY 1972	AUG. 1972	SEPT. 1972	OCT. 1972	NOV. 1972	DEC. 1972
Cash, beginning of month	500	500	500	500	200	--	700	3,700	6,700	6,700	5,700	4,200
Cash in (receipts)	--	--	--	--	--	5,000	9,000	9,000	2,000	--	--	--
Cash, paid out (Disbursements)	--	--	--	300	200	4,300	6,000	6,000	2,000	1,000	1,500	700
Cash on hand, end of month	500	500	500	200	--	700	3,700	6,700	6,700	5,700	4,200	3,500

The cash flow statement shows the following:

1. Cash came into the business in only 4 months — June to September inclusive — the months when the tourist camp was open for business.

2. Cash was paid out in 9 months. Payments made in October, November and December might reflect payment for work needed to winterize the camp, to make repairs and possibly, to add another cabin.

3. Payments in the spring might reflect cost incurred in preparing the camp for opening; payments made in the summer might reflect payments for food, hired help, fuel, interest and principal on loan payments, etc.

4. Note that at the end of May the business had no cash on hand. This situation changed quickly by the end of June when the business had $700 cash.

With this experience to go by, the owner of this business could easily prepare a cash flow forecast for the coming tourist season. He might expect revenues to increase from $25,000 to $30,000 if he opens earlier, with cash costs increasing by $3,500 if he opens the camp for business in May, 1973. The cash flow forecast might look like this:

CASH FLOW FORECAST – BIG NORTH TOURIST CAMP

January 1st, 1973 – December 31st, 1973

	JAN. 1973	FEB. 1973	MAR. 1973	APR. 1973	MAY 1973	JUNE 1973	JULY 1973	AUG. 1973	SEPT. 1973	OCT. 1973	NOV. 1973	DEC. 1973
Cash, beginning of month	3,500	3,500	3,500	3,000	2,500	3,000	4,200	7,700	10,700	11,200	10,200	8,700
Cash in (receipts)	--	--	--	--	2,000	6,000	10,000	9,000	3,000	--	--	--
Cash, paid out (disbursements)	--	--	500	500	1,500	4,800	6,500	6,000	2,500	1,000	1,500	700
Cash on hand, end of month	3,500	3,500	3,000	2,500	3,000	4,200	7,700	10,700	11,200	10,200	8,700	8,000

This cash flow forecast might raise the following questions:

1. Since the business will not need cash until March, (the first "cash, paid out" is $500 in March) possibly the present cash balance, or most of it, should be put in an interest-bearing account.

2. Since the minimum cash position expected will be $2,500 at the end of April, the business seems to have sufficient resources to permit the purchase of some other assets which might be useful in its operation, before cash income for the year actually starts to come in. Possibly, too, the owner might be satisfied that he can readily afford to withdraw from the business the $500 or so he needs to escape to the South for a week or two before his busy season begins.

3. If the business operations are as successful as expected, by the end of the year the business will have $8,000 cash on hand. The owner might wish to plan how to extend the season for his operation, with such resources available for this purpose.

4. Once the business gets into its busy season, monthly cash receipts are forecast to be well in excess of monthly cash disbursements. The owner might decide that a $500 cash balance in the business' chequing account at the bank would be a large enough reserve to provide for contingencies during the summer months. He might therefore decide that any month-end cash balance over $500 would be put in an interest-bearing account until the operating season is over. This could ensure that while this money is earning income it is also readily available for use in the business in the event of an emergency.

CATEGORIES OF CASH RECEIPTS AND DISBURSEMENTS

The cash flow statement and forecast shown on the preceding pages do not show the various sources of cash, nor the uses to which cash was put. When he was preparing the cash flow forecast, this businessman might have broken down cash income in the following way:

- Cabin rentals
- Meals
- Guide fees
- Fishing tackle sales & rentals
- Cruise fees
- Investment

The cash flow statement is different from the profit and loss statement of the business in that it shows all expected cash income from every source. If you invest more money in your business, this will not show up as income to the business on your statement of profit and loss but will show up as an increase in your capital on the business' balance sheet. It becomes part of the total supply of cash used by the business during the year and should therefore be included in the cash flow statement or forecast as a cash receipt. Similarly, if you anticipate selling some of the business' fixed assets, the expected receipts should be brought into your cash flow forecast.

Similarly, the businessman operating Big North Tourist Camp might have broken down his expected cash disbursements into such categories as the following:

- Food purchases
- Guides' wages
- Kitchen staff wages
- Other wages
- Repair costs
- Fuel
- Interest
- Linen & other miscellaneous supplies
- Cash withdrawals (by the owner)
- Loan payments (principal)
- Capital expenditures, for example, a new cabin

Again the list of cash disbursements will not be the same as the list used in your statement of profit and loss. Because they come out of earnings, loan principal payments and cash payments made for depreciable fixed assets will not show as part of the business expenses on your statement of profit and loss. Since they are cash payments, they will need to be taken into account when preparing your cash flow forecast. Depreciation is not included in the list of disbursements because it is not a cash outlay.

USING A CASH FLOW FORECAST

Many businesses compile cash flow forecasts which are far more detailed than the one outlined above. Some businesses prepare cash flow forecasts for periods longer than a year, broken down into periods shorter than a month. Generally, though, a cash flow forecast is done for a year on a monthly basis and is, of course, revised if required by developments during the year.

If your business is engaged in manufacturing, for example, it will undoubtedly be necessary for you to extend credit. You will also need to carry inventories of raw materials and finished products. You will possibly obtain credit from your suppliers, and your bank, and you may also have a loan from a mortgage lender. You may need to replace equipment or buy new machinery or other fixed assets.

To make a cash flow forecast for such a business, you would need to have some idea of what your revenues would be, when your products are sold (for example, the bulk of your sales might occur in the spring and fall months). You would need to know what proportion of these sales might be cash sales. You would need to know what proportion of these sales are for credit, what your credit terms are, what proportion of your customers abide by your credit terms and what proportion of your receivables take longer to collect as well as what proportion you may never collect. You would need to know when you must purchase raw materials and the credit terms of your suppliers.

You might find that at certain times in the year your business does not have sufficient cash on hand to meet its bills. You would then wish to arrange in advance for some temporary assistance from your bank to ensure that adequate cash would be available when needed.

SUMMARY

A business can operate profitably and yet have difficulties because it is starved for cash at certain times of the year. A cash flow forecast will help you predict this and will indicate what remedial action you might take, ahead of time, to avoid cash shortages, for example, the forecast will show what line of bank credit is needed.

A cash flow forecast shows the timing and amounts of all cash receipts and disbursements during the coming year. An operating forecast, which shows expected revenues and expenses for the year, does not indicate fluctuations in your cash position.

A cash flow forecast can tell you:

- when cash is needed
- how much cash is needed
- what cash the business may have available to buy fixed assets or whether it should borrow this money
- whether cash should be invested outside the business for a time until it is needed

No matter how time-consuming it may seem, a cash flow forecast can be very helpful in planning for the future of your business. It can be especially useful in managing one of your business' most vital assets — cash.

CASE
Counselling Assistance to Small Enterprises

The Federal Business Development Bank's Management Counselling Services known as CASE (Counselling Assistance to Small Enterprises) assists small businesses in Canada to improve their methods of doing business.

Virtually any established business or anyone about to engage in a business enterprise can apply provided it has had prior discussion of its needs with its appropriate business advisor(s), and provided it has no more than seventy-five employees.

This service is provided at a moderate fee and supplements counselling services obtainable from the private sector. The counselling is performed by retired business persons selected for their management experience.

To obtain more details on CASE, contact any of the CASE offices listed below or any FBDB branch office.

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MONCTON	860, Main St., Suite 702	(506) 858-2973
FREDERICTON	440 King Street, Suite 646	(506) 452-3022
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Minding your own business

FEDERAL
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DEVELOPMENT BANK

WORKING CAPITAL

Pamphlet No. 9

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WORKING CAPITAL

Pamphlet No. 9

FEDERAL BUSINESS DEVELOPMENT BANK
P.O. BOX 6021, MONTREAL, QUE. H3C 3C3

WORKING CAPITAL

Bob Leduc looked at the papers his accountant had just sent him. One sheet, marked Schedule 2, puzzled him. The heading read "Changes in Working Capital between April 1, 1972 and March 31, 1973."

Bob was a dry cleaner, a good one. He had proven this by running his dry cleaning shop profitably in Minton for nine years. But he was no accountant. The phrase "working capital" was just words without a message. He had heard his good friend, Debra Drew, talk about it. Debbie ran the drug store next door. Maybe druggists learned about working capital at college. Occasionally Debbie grumbled that she was short of working capital, even though her busy store never seemed short of anything.

Bob turned back a page. The top of it read:

LEDUC CLEANERS

Balance Sheet as at March 31, 1973

ASSETS	$	LIABILITIES	$
Cash	100	Bank advances	3,000
Accounts receivable	500	Accounts payable	5,000
Materials & supplies, at cost	800	Mortgage - current instalments	3,000
Total current assets	1,400	Total current liabilities	11,000

This seemed easy enough to follow. All of Bob's customers paid for their cleaning with cash, except the supermarket. Their account for dry cleaning of uniforms was the only account receivable. The inventory of materials and supplies was all there in the shop: cleaning materials, rolls of plastic, hangers, labels, cartons. Not many current assets, but everything needed to run the business.

Bob's business had a $5,000 line of credit from the Foundation Bank down the street. He only used it at certain times during each year and his borrowings had never reached $5,000. So the $3,000 owing to the bank was no problem. Accounts payable of $5,000 looked a little high. Bob decided to have a closer look at that one. So he skipped on to the mort-

gage. The $3,000 was a year's payments on his 10-year loan, originally for $30,000, from the F.B.D.B., for his new equipment. There wasn't much he could do about that.

Back to accounts payable. Bob knew that he had grossed $150,000 for the year, or an average of $12,500 per month. He also knew that his purchases of materials and supplies normally amounted to about 10 % of his revenues. To sell $12,500 in a month he would have had to buy $1,250 of materials and supplies. The accounts payable figure of $5,000 on the balance sheet would therefore be about four months' purchases. All of his suppliers gave him 30-day terms so he must be behind in paying some of them. Or could it be that his monthly sales in February and March had been well above the $12,500 average, requiring heavier purchasing? Or could there be accounts included that were not materials and supplies?

After checking his monthly sales figures and his list of accounts payable at March 31st, Bob found the answer. Sales were $12,900 in February and $11,800 in March. Nothing abnormal about that. But in the accounts payable list all items were materials and supplies, except one, a bill for $3,800 from Grant Electric for his new outdoor sign and new lighting system in the shop. Unpaid bills for normal purchases of materials and supplies were therefore only $1,200 of the $5,000 accounts payable. This was in line with the 30-day terms available.

Debra Drew, the druggist, had said that working capital was the difference between current assets and current liabilities, and that she liked to have twice as many current assets as current liabilities in her drug store business. She had also said that she had trouble in achieving this.

Bob thought about his own situation. He had just convinced himself that his own current assets and current liabilities were in pretty fair shape. But the current liabilities of $11,000 were far greater than the current assets of $1,400. Leduc Cleaners had a working capital deficit rather than a surplus. Yet nothing seemed wrong. Could it be that each business has its own special requirements for working capital? And what do we really mean when we say that working capital is the difference between current assets and current liabilities? What message should this give to the person running the business?

WHAT IS WORKING CAPITAL?

As noted in F.B.D.B. Pamphlet No. 5 "Managing Your Current Assets", current assets are cash and things that can be converted to cash in the near future, usually within twelve months. They are "liquid" assets.

Current liabilities are debts which have to be paid in the near future, normally within twelve months. They are paid by the normal circulation of cash through the business. The main circulation results from converting cash to inventories to accounts receivable and back to cash. In the case of cash sales, the cycle is even shorter: cash to inventories and back to cash when a sale is made. Because of the mark-up of the inventory, and of the service sometimes sold with the inventory, the amount of cash received from a sale is, hopefully, greater than the amount spent on the inventory. Current assets, then, pay for current liabilities.

The ability of a business to pay its current debts on time therefore depends on the amount and timing of this cash circulation from one type of current asset to another: cash to inventory to receivables to cash to inventory to ....If this circulation is fast compared to the time available for payment of accounts payable owing to suppliers, the business will have cash to pay its debts on time, with only a minimum of current assets on hand. At any time, the balance sheet will show a relatively small difference between total current assets and total current liabilities, that is a small amount of working capital. In fact, in a business with a high proportion of cash sales, but with credit terms for its purchases, such as Leduc Cleaners, current liabilities might often be greater than current assets.

Let's take a simple example. Supposing Bob Leduc buys 100 coat hangers. He receives them, along with the invoice specifying 30-day terms, on a Monday. By Friday of the same week they have all been "sold" as part of his dry cleaning service, and he has been paid in cash. He doesn't have to pay for the hangers for another 26 days so he has cash available to pay other bills. He can order more hangers or other supplies and receive cash for them from his customers, and then pay for the first 100 hangers. He has no need for large accumulations of cash, supplies or other current assets in order to pay his bills on time, that is he needs only a small amount of working capital.

So working capital means more than just the arithmetical difference between current assets and current liabilities to the person managing a business. It is really a reflection of the health of each current asset and each current liability under the operating conditions that exist in that business, and none other. The amount of working capital needed in a business is that which results from each current asset and each current liability being at a manageable level, for example no overdue accounts payable.

Most types of businesses do require a working capital surplus, that is, more current assets than current liabilities, because they require large, varied inventories, including slow-moving items, and because they offer credit to their customers, resulting in accounts receivable as a normal fact of doing business. It is the amounts of these and the timing of the operating cycle in each business that determines what amount of working capital is needed. The small business operator needs to know what constitutes a manageable or comfortable level for each of these items in his business. Relying on some arbitrary ratio of current assets to current liabilities can be quite misleading and even wasteful of the assets of the business.

HOW MUCH DO YOU NEED?

Bob Leduc was right. The working capital deficit shown on his March 31 balance sheet was satisfactory for his business at its present sales volume. It provided for payment of current debts as they fell due and it provided the necessary supplies to do business efficiently.

If Bob had tried to predict in January what working capital he should have by March 31 for a sales volume of about $12,500 a month he probably would have estimated as follows:

	$		$
CASH (nominal balance)	100	BANK ADVANCES (half of full line of credit)	2,500
ACCOUNTS RECEIVABLE (1 month's billings to supermarket)	500	ACCOUNTS PAYABLE (30 days' purchases)	1,250
MATERIALS & SUPPLIES (for 15 days, based on purchases of $1,250 / month)	625	PAYABLE - Grant Electric	3,800
		Mortgage - Current	3,000
TOTAL CURRENT ASSETS	1,225	TOTAL CURRENT LIABILITIES	10,550

This estimate would have shown him that a working capital deficit of $9,325 would be satisfactory, with each current item at a tolerable level for the business and its creditors. The figures in the estimate are very close to those which actually existed at March 31 as shown on page 1.

Estimating the working capital requirements of a business requires estimating a workable amount for each current asset and current liability <u>for that business</u>. To make a meaningful estimate requires answers to the following questions:

1. What cash balance is necessary to cover day-to-day needs?

2. What are the receivables normally composed of and what is their likely recovery pattern, in relation to monthly sales? How many "days sales" will normally be awaiting payment?
3. What inventories are required to assure uninterrupted operations at the expected volume of business?
4. What bank credit is available?
5. What terms are available from suppliers and what purchases will be needed on these terms at the expected sales volume?
6. Are there any other current liabilities of significant amounts that will become due during the period considered, e.g., mortgage or lien payments, and in Bob's case, the bill for $3,800 from Grant Electric?

WHAT IF SALES INCREASE?

Many profitable businesses, including Debra Drew's drug store, find their progress hampered at times because of a "shortage of working capital." Their purchasing power diminishes and their credit reputation may even be affected because they cannot pay their bills on time in accordance with the terms available from their suppliers. This sometimes occurs with businesses experiencing a steady growth in sales, when additional working capital has not been provided to support a higher sales volume. What working capital is required when sales volume changes?

Changes in sales volume may occur throughout the seasons of every year without a significant change in annual sales. That is one consideration. The other situation is a significant increase in annual sales due to an overall expansion of business. Both situations warrant careful consideration of working capital requirements.

First let us consider the working capital needs of a seasonal business in which monthly sales vary quite widely during a normal 12-month business year. The critical period will be the peak sales period, the months when accounts receivable and inventories will be highest and support from bank borrowings and suppliers will be heaviest.

Debra Drew's drug store had sales of about $240,000 in each of the past three years, that is an average of about $20,000 per month. In each of those years her December sales were highest, at about $30,000. At June 30th, 1973 her balance sheet showed:

DREW DRUGS

Balance Sheet as at June 30, 1973

ASSETS	$	LIABILITIES	$
Cash	500	Bank advances	5,000
Accounts receivable	4,000	Accounts payable	25,000
Inventory	40,000		
Total current assets	44,500	Total current liabilities	30,000

Sales in June were $20,000 and Debra found this situation quite workable. But what working capital would she need next December? She always seemed short at that time each year.

Debra decided to estimate what her current assets and current liabilities would be at December 1st.

At June 30th her business had $14,500 of working capital, as shown above. She drew up an estimate of her balance sheet (current portion) for December 1st, 1973, based on a $30,000 sales level, as follows:

	$		$
CASH	500	BANK ADVANCES (limit of her credit)	7,000
RECEIVABLES (50% more than June 30)	6,000	ACCOUNTS PAYABLE (50% more than June 30)	37,500
INVENTORY (50% more than June 30)	60,000		
TOTAL CURRENT ASSETS	66,500	TOTAL CURRENT LIABILITIES	44,500

This showed she would need $22,000 working capital at December 1st, but she only had $14,500 at June 30th. The same old story, not enough working capital in December. Where could she obtain another $7,500 before December?

One source would be the profits of the business from June to December. The business had been generating a cash gain (net profit plus depreciation) of only $800 per month during the past three years. If this continued from June 30, 1973 to December 1st, 1973, it would total $4000, assuming none of it would have to be spent during that period on such things as fixed assets or mortgage payments. Working capital would then increase by this amount, from $14,500 at June 30th to $18,500 by December 1st. But the estimated working capital requirement at December 1st is $22,000. So another $3500 or so would have to be found.

Debra looked at her balance sheet again. Surely, with her good bank record the Foundation Bank would be willing to increase her line of credit. She would offer the bank a $20,000 paid-up personal life insurance policy as security. An increase in bank credit of $3500 would probably solve her working capital problem for next December. Debra remembered that this was all based on an estimate, so to allow for error and flexibility she applied for an increase in her line of credit from $7,000 to $12,000. This would give her access to $5,000 more bank credit, if needed. Her application was approved.

She summarized her situation as follows:

Actual working capital at June 30, 1973	$ 14,500
Estimated cash gain July 1 - Dec. 1, 1973	4,000
Estimated working capital Dec. 1, 1973	18,500
Working capital needed Dec. 1, 1973	
- using $7,000 line of credit	22,000
- using $12,000 line of credit	17,000

The new line of credit would assure a comfortable working capital position during the month of December next.

Debra then considered the second type of change in sales volume, moving up to a new plateau in annual sales. She was planning to open a second store in June, 1974 which should increase her total sales by $100,000 to $340,000 in the first year. So December 1974 would bring another working capital crisis. She expected the second store would just break even the first year so the cash gain during 1974 would continue to be $800 per month. She estimated that the combined balance sheet (current portion) for both stores at December 1st, 1974 would look like:

	$		$
Cash	800	Bank advances	12,000
Receivables	8,500	Accounts payable	53,000
Inventory	85,000		
	94,300		65,000

She would need $29,300 working capital, $12,300 more than the $17,000 needed December 1, 1973, in both cases using the full $12,000 line of credit. Should she try to find some new money herself to invest in the business, or again rely on bank or other credit?

She remembered that the business would gain cash of about 12 x $800 = $9,600 in the twelve months. She decided that she would invest another $5,000 in the business in 1974 to bolster the working capital. She again summarized her thoughts as follows:

Estimated working capital Dec. 1, 1973 (using new $12,000 bank credit)	$ 17,000
Estimated cash gain Dec. 1 / 73 - Dec. 1 / 74	9,600
New investment by owner during 1974	5,000
Estimated working capital available Dec. 1,1974	31,600
Working capital required on Dec. 1, 1974 (estimated)	29,300

Debra was satisfied that this plan would satisfy the working capital needs of the business during the peak period of December 1974. It provided a small cushion of $2,300

more than the estimated requirement, in case she did not quite meet the estimated figures.

ADVANTAGES OF ADEQUATE WORKING CAPITAL

Leduc Cleaners and Drew Drugs are typical small businesses with their own unique requirements for working capital. What is the main reason for the very different working capital needs of each of them? In Bob Leduc's case his inventory requirements are small, about $800 to be paid for within 30 days. Debra Drew, on the other hand, had to have an inventory of $40,000, peaking to $60,000 in December, and she too had to pay her suppliers on 30-day terms. Furthermore, Debra ''carried'' $4,000 to $6,000 in accounts receivable, as opposed to Bob's $500. Both businesses have had a successful record, but despite this, serious shortages of working capital could have caused them difficulty, even to the point of failure.

A business which provides for a strong working capital position, particularly at periods of peak sales, will maintain good purchasing power and will be able to buy its inventory requirements and essential services on the best terms. It will not have to jeopardize the quality of its products or services by purchasing sub-standard materials. It will be able to take advantage of trade discounts when available and keep its costs and prices competitive. It will be able to insist on good deliveries of purchases and thus avoid stock shortages or over-stocking. Such a business can point its own way, rather than be directed by its creditors. Its credit reputation will be upheld. Cash will move smoothly into other current assets and back again without obstruction. The business will enjoy a healthy circulation.

CASE

Counselling Assistance to Small Enterprises

The Federal Business Development Bank's Management Counselling Services known as CASE (Counselling Assistance to Small Enterprises) assists small businesses in Canada to improve their methods of doing business.

Virtually any established business or anyone about to engage in a business enterprise can apply provided it has had prior discussion of its needs with its appropriate business advisor(s) and provided it has no more than seventy-five employees.

This service is provided at a moderate fee and supplements counselling services obtainable from the private sector. The counselling is performed by retired business persons selected for their management experience.

To obtain more details on CASE, contact any of the CASE offices listed below or any FBDB branch office.

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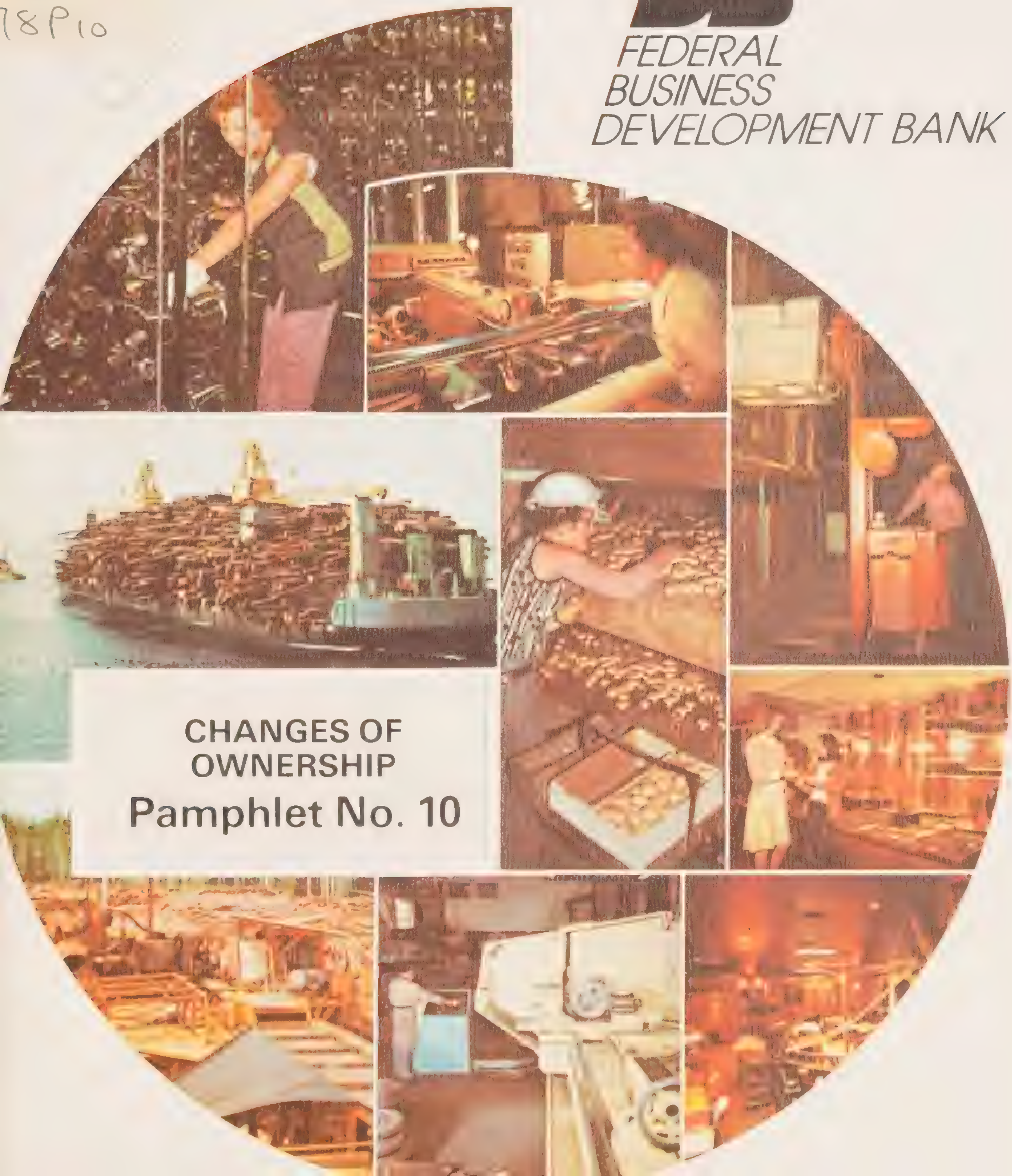

CHANGES OF OWNERSHIP

Pamphlet No. 10

MANAGEMENT SERVICES

The Federal Business Development Bank provides financial and management services to new or existing businesses anywhere in Canada, particularly those of smaller size.

Helping to promote sound management practices in small businesses is an objective of the Bank's management services. As part of this program, FBDB is publishing this series of pamphlets. Copies may be obtained in English or French without charge from any FBDB office, or by mail using the Order Form in the back of this pamphlet.

CHANGES OF OWNERSHIP

Pamphlet No. 10

FEDERAL BUSINESS DEVELOPMENT BANK
P.O. BOX 6021, MONTREAL, QUE. H3C 3C3

CHANGES OF OWNERSHIP

INTRODUCTION

Each day several small Canadian businesses change hands. For buyers and sellers alike, such changes of ownership are major events. The process is complex. Clear understanding of it, and careful planning of each step are needed for a logical, unemotional decision. The transaction can then be closed in proper legal form, safe and fair for both parties.

This pamphlet outlines some of the key considerations involved in the change of ownership of a business. For simple illustration the case of a proprietorship is used, although similar considerations will apply to partnerships and to companies. In any case, the buyer and seller must be willing to invest enough effort in preliminary work to avoid waste of time, money and disappointment.

SELLING A SMALL BUSINESS

The seller has several ways of attracting prospective purchasers. More than one or all of the following common methods can be used to suit the circumstances:

- Word-of-mouth, including suppliers
- Newspaper advertising - classified ads section
- Real estate broker
- Trade publications.

The selection of the means used would be governed by the circumstances prompting the sale; the seller would have to decide whether prior publicity would harm the business and therefore adversely affect its price.

<u>Word-of-mouth</u> contact by itself is probably the least effective means, unless the seller knows of an interested party willing to negotiate.

<u>Classified newspaper advertising</u> is inexpensive and effective provided the ad is specific as to price, location and size of the business. The seller should decide whether he wants replies to his address, through a box number, by direct telephone or through an

answering service.

Real estate brokers specializing in business opportunities can assist in finding and screening buyers and in ensuring all the proper legal steps are taken. The commission is often well spent in protecting the seller from wasted effort at all stages.

Trade publications are effective in reaching prospects directly interested in the type of business being sold. This method eliminates most of the frivolously minded.

If the seller puts himself in the place of the buyer, he can readily prepare and assemble the data a prudent investor would reasonably expect to be available to him. This material should include the following:

1. A written history of the business to the present and a statement of its potential.
2. Balance sheets and operating statements for prior years and a recent interim statement.
3. A written argument setting out the basis of establishing and evaluating the seller's asking price.

DETERMINING THE PRICE

Establishing a fair price is the biggest problem. The seller understandably tries to put a price on the effort and money he has invested in the business. But the buyer is mainly interested in the ability of the business to yield a fair return on his investment after giving him a reasonable salary. Therefore the present state and future potential interest him most, to determine whether the business will yield a return on investment at least equal to, if not better than, alternative sources. If such is not the case, the prospective buyer would be unlikely to offer more than the value of the **tangible assets.** As the term suggests, these are assets which can be touched, weighed or measured and have real value. He would not ascribe any value to "goodwill" which in one sense is directly related to the earning power and potential of the business.

The seller, then, must forget about his prior investment of money and effort and base his price realistically on present and future factors. He might select the following steps in determining his price formula:

(1) Establish the tangible net worth of the business (that is, assets less liabilities, ignoring any intangible assets such as goodwill).

(2) Estimate what dollar return — perhaps 10% — an investor would get on this amount if invested elsewhere with approximately the same degree of risk. This is called "earning power".

(3) Add a reasonable salary for the new owner.

(4) Establish from the operating statements the average annual net earnings before taxes (net profit before deducting owner's drawings) for the past few years. This gives a means of comparing the historical earnings with those the prospective buyer could get from alternative sources open to him. The trend of historical earnings is the key factor.

(5) Deduct the earning power (2) plus reasonable salary (3) from the average net earnings (4) to determine the business' "extra earning power".

(6) To value the intangibles, multiply (5) by the number of years of profitable operation. A well-established and successful business would justify using a factor of five or more; a less well-based enterprise might suggest a factor of three as appropriate.

(7) Final asking price=tangible net worth (1) plus value of intangibles (6)

Applications of the price formula described to evaluating two businesses up for sale are illustrated below: -

	Business A	**Business B**
(1) Tangible net worth	$40,000	$40,000
(2) Earning power - 10% of (1)	4,000	4,000
(3) Reasonable salary for owner	10,000	10,000
(4) Average net earnings	16,000	12,000
(5) Extra earning power (4) minus (2) and (3)	2,000	-2,000
(6) Value of intangibles (5) times 5	10,000	Nil
(7) Final asking price (1) plus (6)	$50,000	$40,000

In the case of Business A, we see the seller should get a substantial price of $10,000 for the intangibles (mainly "goodwill") because the business is well established and is probably earning more than the potential buyer would likely get elsewhere with comparable effort and risk. The buyer would in this example recover the cost of goodwill (6) in five years. The reasoning is that if the business continues to average $16,000 net earnings per year, the buyer will realize his 10% return of $4,000, his salary of $10,000 plus $2,000 extra earnings each year. This last amount would equal, in five years, the $10,000 he paid initially for the goodwill.

For Business B, there is no goodwill value because there is no extra earning power (5) and a prospective buyer might even conclude that the business was not worth its tangible net worth (1) because of the poor return on an investment of that size. Intangible assets often include patents, franchises, organization expense, trade marks and goodwill.

BUYING A SMALL BUSINESS

Most of the considerations the seller should examine apply equally to the buyer who firstly has to:-

1. Select the size and type of business best suited to his interests, his character, capital available and prior experience.
2. Seek out opportunities meeting his requirements.
3. Evaluate each opportunity.
4. Ensure the transaction is handled properly.

The selection of the type of business is a personal one about which advice could be obtained from banks or from acquaintances already in the same line of business.

The seeking of opportunities can be assisted by scanning the classified ads in newspapers serving the preferred area. Similarly, local realtors can often provide useful leads and assist greatly in putting the deal together at no cost to the buyer.

The evaluation of each opportunity on a comparative basis is crucial to the prospective buyer and his conclusions will determine what would be a fair price for the

business. His analysis should include:

a) the reason the business is up for sale

b) its assets and liabilities

c) its history, location and potential

d) its profit record, operating ratios and projections.

He should not rush his investigations; time to get the needed information will pay off in reaching the decision whether to purchase and at what price. Some successful business owners report they considered alternatives for a year or more before deciding to go ahead.

An adverse trend apparent from the financial statements may reveal the true reason for selling; the prudent buyer should establish the reasons for such a trend and determine whether it is reversible or whether, for example, changes in the character of the neighbourhood are responsible.

One of the principal assets often involved in a change of ownership is the inventory. A physical count preferably by an independent appraiser should be taken to establish a fair price for it having regard to its saleability, condition and style and after making due allowance for any items that would have to be cleared out at a loss.

Similarly, the accounts receivable should be analysed for quality and aging. This simple analysis is an indication of the seller's credit and collection policies and of the level of operating capital required to support day-to-day operations. F.B.D.B. Pamphlet No. 5 called ''Managing Your Current Assets'' deals more fully with these two aspects. If realty is involved in the prospective change of ownership, a professional appraisal of its value might be money well spent, since its condition and versatility should be reflected in the price offered. What alterations are needed and at what cost? Similarly the furniture, fixtures and equipment should be assessed.

The cautious buyer should determine there are no hidden liabilities such as unregistered liens against equipment, back taxes, pending law suits. An accountant's or lawyer's help at this stage would be wise. The agreement of purchase and sale should spell out that all claims not shown on the balance sheet used as the basis of sale are the responsibility of the seller.

The last two areas of evaluation, history, location and potential plus the financial data, should be made available by the seller (page 2) for the buyer's use. A wise buyer should prepare an operating projection for the first 12 months under his ownership, reflecting as closely as possible all changes he would propose to make in the running of the business. To assist him, he could refer to F.B.D.B. Pamphlet No. 4 — "Forecasting for an Existing Business".

The financing of the transaction must now be considered, assuming buyer and seller have reached agreement on price. The buyer will know how much cash he can safely invest in the business, leaving some in reserve in case of need, and how much assistance he can count on from his banker or other lender. Perhaps the seller is willing to finance part of the sale himself, that is, in effect to make a loan to the buyer, possibly secured by a mortgage on the business' fixed assets and repayable with interest over a term acceptable to both parties. Remember that whether the transaction is on an all-cash basis or partly financed should not affect the selling price.

CONCLUSIONS

The buyer should insist on full disclosure of all facets of the business he's interested in purchasing. He should not be stampeded into making a snap decision but should insist on adequate time to do the necessary research which would also involve seeking the advice of an accountant, a lawyer and possibly a real estate broker.

The formula discussed on pages 3 and 4 is not offered as a universal method of price evaluation but is a valid mathematical approach based on the financial standing of the business. Money is only one of the important factors; the buyer may be attracted to the location for personal reasons which could include a burning desire to be self-employed. Similarly, the seller's decision to dispose of the business may be very legitimate, such as poor health, the desire to retire or to relocate. Whatever the reason, the buyer should make it his business to find out.

CASE

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The Federal Business Development Bank's Management Counselling Services known as CASE (Counselling Assistance to Small Enterprises) assists small businesses in Canada to improve their methods of doing business.

Virtually any established business or anyone about to engage in a business enterprise can apply provided it has had prior discussion of its needs with its appropriate business advisor(s), and provided it has no more than seventy-five employees.

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St-Leonard, 254-6073
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L2R 7A7

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M5V 1V6

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M3H 3S3

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59 Adelaide St. South,
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P.O. Box 474, Islington,
M9A 4X4

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2978 Eglinton Ave. East,
P.O. Box 798, Stn. A, M1K 5C8

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340 George St., North,
P.O. Box 1419, K9J 7H6

Prairie and Northern Region

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R3C 3R6

Brandon, Man. 727-8415
136-11th Street, P.O. Box 6,
R7A 5Y6

Regina, Sask. 569-6478
2220-12th Avenue,
S4P OM8

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Midtown Plaza, S7K 1J5

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740-4th Avenue South,
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Edmonton, Alta. 428-9111
10150-100th Street,
T5J 0P6

Edmonton South, Alta. 436-6533
11044-51st Avenue,
T6H 5B4

Red Deer, Alta. 343-3232
4919-59th Street,
T4N 6C9

Calgary, Alta. 269-6981
404 Sixth Ave. S.W.,
T2P OR9

Calgary South, Alta. 253-6501
5940 MacLeod Trail S.W.,
T2H 2G4

Grande Prairie, Alta. 532-8875
10135-101st Avenue,
P.O. Box 10, T8V 3A1

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5010-50th Avenue
X1A 1C8

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Travelodge Commercial Mall

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1100-1st Avenue East,
P.O. Box 520, S6V 5R8

St-Boniface 233-6791
Bay 6 West,
851, Lagimodiere Blvd.,
Winnipeg R2J 3K4

Edmonton West, Alta. 452-3232
11574-149th Street,
T5M 1W7

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V1C 2P1

Kelowna, 762-2035
260 Harvey Ave.,
V1Y 7S5

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235 First Ave.,
V2C 3J4

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Kamar Plaza,
45850 Yale Rd. West,
V2P 2N9

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V2L 3L5

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V3L 3A5

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Vancouver, 681-7484
885 Dunsmuir St.,
V6C 1N7

Victoria, 388-0161
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V8V 3K2

Campbell River, 287-9236
906 Island Highway,
V9W 2C3

Terrace, 635-4951
4548 Lakelse Ave.,
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Burnaby, 438-3581
4240 Manor St.,
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Richmond, 273-8611
3751 Shell Rd.,
V6X 2W2

Nanaimo, 753-2471
190 Wallace St.,
V9R 5B1

Langley, 533-1221
20316-56th Ave.,
V3A 3Y7

Vancouver-East, 873-6391
3369 Fraser St.,
V5V 4C2

Vernon, 545-7215
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V1T 5E4

Williams Lake, 398-8233
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V2G 2A2

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V2S 3S1

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Duncan, 748-5202
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- No. 6 ☐ Forecasting for a new business
- No. 7 ☐ Managing your fixed assets
- No. 8 ☐ Managing your cash
- No. 9 ☐ Working capital
- No. 10 ☐ Changes of ownership
- No. 11 ☐ Planning a motel
- No. 12 ☐ Equity capital for small companies
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NOTES

Minding your own business

FEDERAL
BUSINESS
DEVELOPMENT BANK

PLANNING A MOTEL

Pamphlet No. 11

[redacted]

MANAGEMENT SERVICES

The Federal Business Development Bank provides financial and management services to new or existing businesses anywhere in Canada, particularly those of smaller size.

Helping to promote sound management practices in small businesses is an objective of the Bank's management services. As part of this program, FBDB is publishing this series of pamphlets. Copies may be obtained in English or French without charge from any FBDB office, or by mail using the Order Form in the back of this pamphlet.

PLANNING A MOTEL

Pamphlet No. 11

FEDERAL BUSINESS DEVELOPMENT BANK
P.O. BOX 6021, MONTREAL, QUE. H3C 3C3

PLANNING A MOTEL

The motel business isn't as easy as it sometimes looks. In the middle of July when you can't find a place to stay it seems as though a motel operator just stands behind the desk and rakes in the money. It's not that simple though, because the cash register that tinkles so merrily in July may, in February, make that happy sound so infrequently that you'll wonder where the tinkle went.

In the world of sports a lot of thought and hard work is necessary to make contenders of expansion hockey teams. It's the same in the world of business. Start with the idea that you will have to spend a lot of thought and hard work on making your motel business a "contender" — by seeing a lot of black figures in the "net profit" section of your operating statement.

While thought and hard work do not guarantee success, they are generally vital to it. The purpose of this pamphlet is to outline some of the major areas to which thought and work should be devoted if you are considering starting your own motel business.

Let's assume that you have been considering starting a motel of your own for a while and that you have now decided that you'd like to think seriously about a motel business in a particular area. There will be many reasons why you become interested in establishing a motel at a particular place, and once you've decided to consider it seriously you can start detailed planning.

1. LOCATION OF THE MOTEL:

(a) Land

You will want to find out:

- what pieces of property are available.
- the dimensions of the available piece of property.
- prices.
- whether or not the pieces of property are serviced with the necessary utilities, or whether you will have to arrange for septic tank and well services.

- the favourable and unfavourable features of particular pieces of property. Some may require fill — and this may or may not be reflected in the going price for such land. An otherwise attractive piece of land might be downwind of a neighbouring feedlot and would therefore not be a prime location.

(b) Highways

You should get information on the following:

- distance to nearest highway and highway intersections. Will your motel be visible from the highway?
- locations of signs to tell motorists of the existence and location of your motel.
- access to your motel from the highway.
- plans for highway relocation or other changes that might affect your motel.
- traffic counts, on at least a monthly basis for several years if available.

(c) Other centres and business facilities

- distance to nearest town and nearest large city.
- distance to town's business centre.
- check to see if the route from your motel to the business centre is a direct one.
- check to see if motorists travelling to the business centre from out of town would travel by your motel.

(d) Other facilities

- check distances to, and availability of, restaurants, gas stations, barber shops, beauty salons, recreational facilities such as bowling, golf, tennis, swimming, skiing and movie theatres.

(e) Customers

- check for possible sources of business such as airports, large factories, resort areas, military bases and hospitals. If possible, find out how many transients visit these places.

- find out about camping facilities. These may help your motel since they may draw people to the area who might decide in bad weather that they would prefer to stay at a motel for a night or two rather than camp out.

(f) **Where are your competitors located?**

(g) **What will make travellers stop at this location?**

2. THE MOTEL SITE:

Sketch out the properties which seem to be of interest and show:

- boundary measurements.
- location of roads, driveways, parking spaces, adjoining highways (indicate whether latter are gravel or paved).
- location and possible dimensions of buildings, tile beds, fuel tanks.
- special facilities such as swimming pools, shuffleboard courts, docks, beach.
- signs and floodlights.

Features peculiar to the particular pieces of property should also be noted (for example, the view, topography, type of soil and terrain, drainage, etc.).

3. BUILDING:

- Prepare a floor plan of the building as you initially envisage it, showing the location of rental units, office space, lobby, other facilities (restaurant, cocktail lounge, etc.), stairways, entrance and exits.
- Prepare a floor plan for each type of accommodation offered (single, double, housekeeping) showing typical furniture arrangement.
- Outline construction type and finish for walls (interior and exterior), roof, floors, windows and doors.
- What plumbing facilities will be needed?
- What type of heating system will be needed? What areas will be air-conditioned? Is heating / air-conditioning to be controllable in each unit?

- Make a list of the furniture, fixtures and equipment items you will need; you can probably check with suppliers to be sure your list is complete.
- Check with local authorities concerning building codes, building permit regulations, etc.
- When your ideas on what size motel you wish to construct and what facilities it should have are relatively firm, you will want to get preliminary bids from contractors on the costs involved. At this stage, though, let's assume that you are gathering information with a view to deciding just what you would like to do.

4. THE MARKET:

The basic question, of course, is: "How many units can I expect to rent, at what prices and at what times during the year?" As a general background to the answer you may come up with, you should first of all get information on the growth in population and business and on any resort and highway development in the surrounding area. If the town in or near which you will be located is thriving and growing, this should be a good sign as it may continue to do so in future. Local Chambers of Commerce, city or town officials, Statistics Canada and provincial government departments can be of assistance in providing you with this type of information. Local real estate agents can give you information on land prices and trends, activity in residential and other development and a great deal of information on the local economy, as can local business executives, other motel operators (or their associations) and the officials of motel chains with which you might be considering becoming associated.

Personal observation of the business activity of existing motels in the immediate area should assist you in assessing what your share of the market might be. Local real estate brokers could tell you the frequency and price levels of recent motel sale transactions. Rates charged for various types and quality of accommodation are easy to determine and will assist you in setting your own rate structure.

5. OPERATING FORECAST:

Having obtained all this information, and having an idea of how many units you might expect to rent and at what rates, you should then prepare a detailed operating forecast on at least a monthly basis and for at least the first year or two of operation. (F.B.D.B. Pamphlet No.6 — "Forecasting For a New Business" — may help you here.) Some expenses will be the same each month, some will rise and fall seasonally and some will occur in only a few months of the year. The major items to be considered (and here we are referring to a straight unit rental motel operation without facilities such as a restaurant and cocktail lounge or beverage room — these and their associated costs and revenues should be the subject also of detailed analysis) are as follows:

(a) **Labour** — even though you may plan to do most or some of the work yourself, there will still be peak-season needs and some allowance should be provided for sickness and vacation. How long will it take to service one unit? How many units will need to be serviced? How many hours of "outside" labour must be hired? What are the going rates of pay for this type of labour in the area? Consider other costs such as unemployment insurance, etc.

(b) **Supplies** — what are the costs of soap, matches, towels and linens, glasses, stationery and cleaning supplies? Whether an individual item is to be considered a supply item depends on the likelihood of its being "used up" in one year. You should, as a part of the cost of getting the motel established, list the type and number of supply items you will need and calculate the investment in "opening inventory" which you will need.

(c) **Laundry** — find out local rates, determine costs for one motel unit and calculate the monthly costs using the percentage of occupancy developed earlier.

(d) **Heating** — local heating contractors can estimate this for you.

(e) **Electricity** — the local Hydro office can estimate this for you.

(f) Property taxes — estimates of these can probably be obtained from the local taxing authorities. (Don't forget that you may have to pay a business tax in addition to a realty tax).

(g) Water rates — these can be obtained from the local utility service.

(h) Maintenance — if the motel is new you may not need to spend much money in the first year or two on maintenance. This is an area where operators' associations may be of assistance.

(i) Sign rental — if rented.

(j) Ground costs — includes grass cutting, flower bed preparation, fertilizing, snow removal, etc. — local gardeners and others can provide useful information.

(k) Professional fees — ask local firms of accountants what they would charge to set up a bookkeeping system and either keep it up themselves or assist and train you to do so. Professional fees are frequently paid once a year but ask if there are to be variations.

(l) Insurance — get quotes from local agents.

(m) Interest on debt — how much money do you need to borrow? At what rates of interest? When will the interest have to be paid? (Usually monthly).

(n) Advertising — check the costs of advertising in various media — radio, newspaper, brochures, etc.

(o) Depreciation — although this does not involve an outlay of cash, depreciation should be calculated as the business will have to generate the funds needed to replace assets as they wear out and get used up. In other words, before you can determine if a business is to be profitable you should find out if enough revenues can be obtained to spread the cost of assets (other than land) over their expected useful life. Your accountants can give you up-to-date information on the rates applicable to various types of assets.

(p) Personal living expenses — the salary to be paid to the owner of a limited company or the drawings of the proprietor or partner.

The answer you come up with after subtracting the expenses from the expected revenues will give an indication of the profitability of the proposed venture into the motel business.

6. THE DECISION:

In order to get reasonable estimates for the expenses listed above, you have to have an idea of how much the motel project is going to cost. By now you probably have a reasonably good idea of the number of clients you can expect and therefore the number of units you wish to construct. As well, you probably have a reasonably good idea of the basic design you would like, assisted by builders' or architects' plans. On the basis of the information you have already gathered, you can now go about getting firm bids from a number of contractors. You will then know how much money you need to borrow to construct the motel, what its costs of operation should probably be, and how much money will be required to make the principal payments on the money you borrow. You should discuss these requirements with lenders. Remember that you shouldn't commit yourself to construction of the motel until you know you have the money available to pay for it.

A form which you might find useful as a checklist for the costs involved in putting up the building is shown at the end of this pamphlet. This list does not include furniture and furnishings for the motel units, or supplies.

If the motel project still seems sound after you have got all your costs together, you should consider taking out an option on the most desirable piece of property (to ensure that a sudden sale of the land does not put your plans in jeopardy).

All this preparation will have other benefits. As well as satisfying yourself that the project is a good one, it will also be very useful to any lender you may approach for financing; this work will help you prepare the basic financial information which a lender will want to see:

- an opening or pro forma Balance Sheet.
- an operating (profit and loss) forecast.
- a cash flow projection.

F.B.D.B. Pamphlets No. 3 "Presenting Your Case for a Term Loan" and No. 8 "Managing Your Cash" provide more details.

7. FUTURE PLANNING:

Your work in planning for the business doesn't stop when the motel is finished and in operation. As well as keeping a close watch on costs, you should continually re-assess your advertising programme. You can develop a method of finding out how clients learned of your motel. You should keep a daily record of how many units are rented and, particularly, how many possible customers are turned away. The latter will be of great importance if it seems you should consider constructing additional units because with this information you are in a position to make an informed forecast on how profitable the additional units will be and how many new units should be added.

....

BREAKDOWN OF LAND AND BUILDING COSTS

GENERAL:	
1. Permits, plans, surveys	$
2. Supervision Fees	$
LAND:	
3. Land purchase price	$
SITE WORK:	
4. Clearing	$
5. Services: Sewage	$
Water	
6 Excavation	$
7 Fill	$
8. Paving (gravel)	$
9. Landscaping	$
10. Fencing	$
11. Labour	$
CONCRETE:	
12. Footings	
13. Foundations	$
14. Reinforcing	$
15 Floors	$
16. Labour	$
STEEL:	
17. Joists	$
18. Columns	$
19. Labour	$
WALLS:	
20. Concrete blocks	$
21. Masonry	$
22. Woodwork	$
23. Partitions	$
24 Drywall	$
25 Sheeting	$
26 Insulation	$
27 Labour	$
OPENINGS:	
28. Doors	
29 Overhead Doors	$
30. Windows	$
31 Ventilation	$
32 Labour	$
ROOF:	
33. Roofing	$
34. Labour	$
Carried forward	$

BROUGHT FORWARD	$
FINISHES:	
35. Millwork	$
36 Floors	$
37. Acoustical Ceiling	$
38. Furnishings	$
39. Labour	$
ELECTRICAL:	
40. Wiring	
41. Fixtures	$
42. Service	$
43. Labour	$
PLUMBING:	
44. Materials	$
45. Labour	$
HEATING:	
46. Materials	$
47. Labour	$
PAINTING:	
48. Materials	$
49. Labour	$
HARDWARE:	
50. Materials	$
51. Labour	$
SPECIALTIES:	
52. Air-conditioning	$
53. Elevators	$
54. Sprinkler	$
55. Sign	$
OTHER ITEMS:	
56.	$
57.	$
TOTAL COST	$

Notes 1. Note with * where firm price has been obtained. (not an estimate)

CASE
Counselling Assistance to Small Enterprises

The Federal Business Development Bank's Management Counselling Services known as CASE (Counselling Assistance to Small Enterprises) assists small businesses in Canada to improve their methods of doing business.

Virtually any established business or anyone about to engage in a business enterprise can apply provided it has had prior discussion of its needs with its appropriate business advisor(s), and provided it has no more than seventy-five employees.

This service is provided at a moderate fee and supplements counselling services obtainable from the private sector. The counselling is performed by retired business persons selected for their management experience.

To obtain more details on CASE, contact any of the CASE offices listed below or any FBDB branch office.

CASE Offices

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Atlantic Region		
ST. JOHN'S	4th Floor-Beothuck Building	(709) 737-5515
CORNER BROOK	Third Floor, 4A Herald Ave.	(709) 639-9126
HALIFAX	Suite 914, Cogswell Tower	(902) 426-2474
MONCTON	860, Main St., Suite 702	(506) 858-2973
FREDERICTON	440 King Street, Suite 646	(506) 452-3022
CHARLOTTETOWN	139 Kent Street	(902) 892-3576
Quebec Region		
MONTREAL	800 Victoria Square	(514) 283-4384
QUEBEC CITY	925 Chemin St. Louis	(418) 694-3003
SHERBROOKE	2532 King St., West	(819) 565-4757
LAVAL	2525 Marois Blvd.	(514) 681-9291
CHICOUTIMI	475 rue de Champs Elysées	(418) 545-1501
LONGUEUIL	1000 de Serigny Street	(514) 670-0633
ST. LAURENT	750 Laurentian Blvd.	(514) 748-7470
Ontario		
TORONTO	5th Floor 204 Richmond St., West	(416) 593-1143
HAMILTON	8 Main Street	(416) 523-2954
SAULT STE. MARIE	421 Bay Street	(705) 949-1997
LONDON	197 York St., Suite 100	(519) 432-6705
OTTAWA	151 Sparks Street, Suite 1005	(613) 238-6253
OSHAWA	22 King Street, West	(416) 571-1355
TORONTO NORTH	4430 Bathurst Street Downsview, Ontario	(416) 638-1340
Prairie & Northern Region		
CALGARY	404 Sixth Ave., S.W.	(403) 269-6981
EDMONTON	10150—100th St.	(403) 428-9111
REGINA	2220—12th Avenue	(306) 569-6478
SASKATOON	1203 CN Towers	(306) 665-4050
WINNIPEG	386 Broadway Ave., Suite 101	(204) 944-9991
LETHBRIDGE	740—4th Avenue South	(403) 328-9681
British Columbia Region		
VANCOUVER	885 Dunsmuir St.	(604) 681-7484
NORTH VANCOUVER	145 West, 15th Street	(604) 980-6571
NEW WESTMINSTER	227 6th Street	(604) 525-1011
KELOWNA	260 Harvey Avenue	(604) 762-2035
KAMLOOPS	235 First Avenue	(604) 374-2121
VICTORIA	990 Fort St.	(604) 388-0161
NANAIMO	190 Wallace Street	(604) 753-2471

F.B.D.B. Branch Offices

Atlantic Region

St. John's, Nfld. 737-5505
Beothuck Bldg., Crosbie Place,
P.O. Box 8805, Stn. A, A1B 3Y8

Sydney, N.S. 539-4556
48-50 Dorchester St.,
P.O. Box 726, B1P 6H7

Charlottetown, P.E.I. 892-9151
137 Kent St.,
P.O. Box 488, C1A 7L1

Halifax, N.S. 426-7850
Suite 710, Cogswell Tower
Scotia Square, B3J 3K1

Edmundston, N.B. 739-8311
109 Rice Street,
P.O. Box 610, E3V 3L2

Moncton, N.B. 858-2370
860 Main St.,
P.O. Box 1090, E1C 8P6

Saint John, N.B. 658-4751
75 Prince William St.,
P.O. Box 7173, Stn. A, E2L 4S6

Corner Brook, Nfld. 639-7113
Herald Tower, Herald Ave.,
A2H 6G7

Truro, N.S. 895-6377
CN Commercial Centre,
34 Esplanade St.,
P.O. Box 1378, B2N 5N2

Fredericton, N.B. 452-3030
King's Place Complex,
440 King St., Suite 649,
P.O. Box 13, E3B 4Y3

Grand Falls, Nfld. 489-2181
42 High St., P.O. Box 744,
A2A 2M4

Bathurst, N.B. 548-3345
270 Douglas Ave.,
P.O. Box 780, E2A 4A5

Bridgewater, N.S. 543-7821
655 King St., P.O. Box 540,
B4V 2X6

Quebec Region

Sept-Iles, 968-1420
690 Laure Blvd., Suite 152,
G4R 1X9

Rimouski, 724-4461
320 St. Germain St. East,
G5L 1C2

Chicoutimi, 545-1580
475 des Champs Élysées St.,
G7H 5V7

Quebec, 681-6341
925 Chemin St. Louis,
G1S 1C1

Sherbrooke, 565-4740
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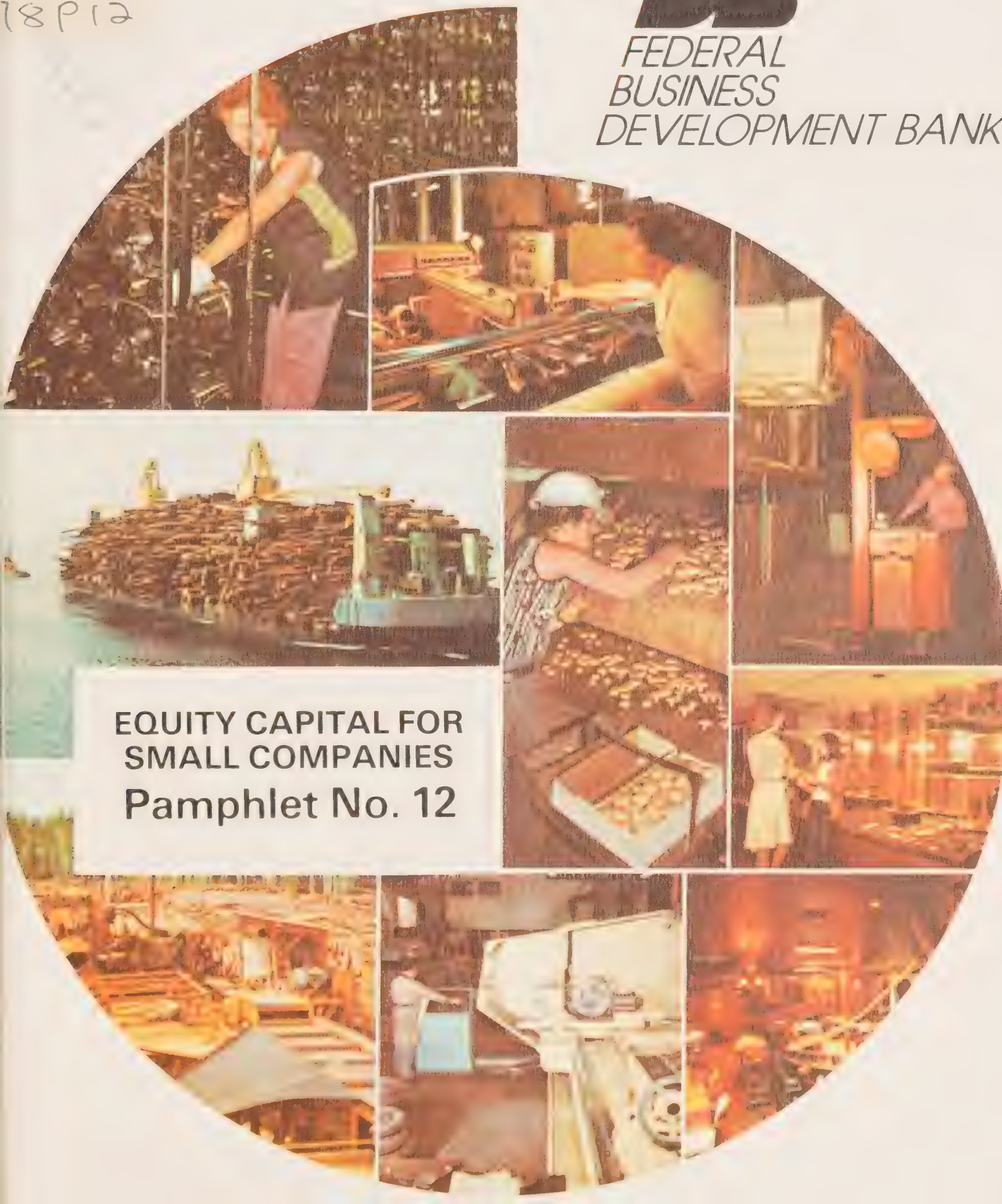

EQUITY CAPITAL FOR SMALL COMPANIES

Pamphlet No. 12

[redacted]

MANAGEMENT SERVICES

The Federal Business Development Bank provides financial and management services to new or existing businesses anywhere in Canada, particularly those of smaller size.

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EQUITY CAPITAL FOR SMALL COMPANIES

Pamphlet No. 12

FEDERAL BUSINESS DEVELOPMENT BANK
P.O. BOX 6021, MONTREAL, QUE. H3C 3C3

EQUITY CAPITAL FOR SMALL COMPANIES

FOREWORD

The owners of any business strive to ensure that it does not merely stand still but grows in sales, profits and assets. Expansion usually involves additional investment in both fixed and current assets. The profits of the business may not be adequate to meet this need, necessitating the introduction of new funds from sources outside the business. This financing is usually achieved by borrowing or by the introduction of new equity – or owned – money, or by a combination of both sources. This Pamphlet is addressed to equity financing; debt financing is the subject of Pamphlet No.3 "Presenting Your Case for a Term Loan".

EQUITY CAPITAL FOR SMALL COMPANIES

The Balance Sheet of any business is a photograph of its financial position on a certain date. It consists of three basic parts; the assets or what it owns and what is owing to it; liabilities or debts, and the equity or owners' capital. Let's be clear what the term 'equity capital' means. There are many definitions of it but the simplest is that the equity in any business is that part of the money invested in it which is not debt.

THE ADVANTAGES OF USING EQUITY CAPITAL are:-

- to permit faster growth of the company by raising money.
- to expand the borrowing power of the company.
- to improve the company's credit rating with its suppliers.
- to reduce the risk to each owner of the business.
- to spread the ownership of the company over more shareholders who may be more venturesome than if only a few owners are involved.
- to gain the experience and counsel of new shareholders.

The company should always raise additional equity before the need for it becomes urgent. If the search for new investors is delayed until all other sources have been exhausted, bargaining power is weakened and new capital may only be available on rigorous terms.

THE DISADVANTAGES OF USING EQUITY CAPITAL include:-

- a possible lessening of flexibility because of shared ownership.
- the dilution of ownership interest of the original owners.
- possible increased expenses such as costs incurred in issuing the stock, dividend payments and accounting.

The sole owner of a business enjoys complete flexibility of operation and in the decision-making process. He does not need to consult anyone; he can take risks that a financial partner may not wish to share. In short, he is his own boss. The sale of stock to new investors is really the same as admitting new partners to the business whereby the sole owner has to share control with others and he probably becomes an employee of the company's owners of whom he is one.

Selling partial ownership in a business by introducing new investors reduces the original owners' share in the company's profits. On the other hand, the refusal to sell additional shares could impair the growth of the business or allow competitors to overtake it. Conversely, the premature sale of stock in a growth company could subsequently make the original owner reluctant to reduce further his ownership interest even though the new funding was vitally needed.

The sale of a portion of the equity usually involves additional expenses. Legal fees may be involved, and where professional assistance is engaged to raise the capital, such as a brokerage house, commission will be payable. The business' accounting system will probably have to be expanded for the protection and information of the new investor co-owners. A more disciplined standard of conduct for the original owner may be forced upon him when he reduces his share of the ownership by selling part of it to others.

DEBT OR EQUITY?

When and how to finance is one of the toughest problems a businessman has to face. There is no simple answer to the question of whether to finance by debt or equity because of the circumstances peculiar to each business faced with the problem. It would therefore be prudent to seek advice from a professional accountant; his recommendation would most likely include suggested sources of financing of either type for evaluation and comparison by the businessman.

SOURCES OF EQUITY CAPITAL FOR SMALL COMPANIES

Under the free-enterprise system the basic law of supply and demand applies to the issuance of the securities of any company, large or small. Just as the business' products or services have to be attractive to create and retain customers, so do the securities

offered to new investors. Share offerings of small, relatively unknown companies are often not attractive to the "ordinary" investor because stability and a regular pattern of profit have yet to be established. However, such securities often prove attractive to those in high tax brackets who may be more interested in the prospect of capital gains than in further increasing their incomes through a stable dividend payment pattern.

Small businesses rarely have access to a public offering. Investment dealers and underwriting houses have necessarily to be convinced of the marketability of a proposed public offering among their clientele. Furthermore, the cost of placing a small issue for a small company is usually disproportionate to the net yield to it in new equity funding. So the small company that wants to become bigger by increasing its share capitalization will probably first seek private sources of equity capital.

PRIVATE SOURCES

Internal sources of equity capital would comprise additional investment by the present owners and perhaps the sale of shares to employees of the company — a form of employee profit-sharing.

External sources for a small company would include relatives and friends of the owner and even customers and suppliers. The latter two possible sources may, however, result in undue restrictions on the company's operations and could induce reluctance by other customers and suppliers to deal with it. Often a single professional investor or group operating as a syndicate will provide equity capital directly to a small business if the issue is seen as being of more than usual attractiveness. Such people can be identified by the company's bank manager, accounting firm or lawyer who have knowledge of other clients' interests and aspirations.

NON-PRIVATE SOURCES

For the small company these sources would exclude the general public for the reasons given earlier. Similarly, mutual funds usually confine their investment portfolios to large, well-established and well-known companies. Their investor-clients — often individuals without intimate knowledge of the stock market or of financial matters generally — rely on the expertise of the mutual fund operators to invest and administer

their funds at risk. But the small company can turn to several non-private Canadian sources of equity capital, one of which is often overlooked — other companies.

Larger companies are quite often willing to invest in smaller ones, not necessarily to the point of taking them over completely, but limiting their share interest to some maximum percentage of ownership which is often less than sufficient to acquire control. The motives for such larger companies would include the desire to retain contact with an individual or to buy an interest in a development pattern in a field in which they were not themselves active. Alternatively, the operations of the larger and of the smaller company may complement each other, and the case of a large company acquiring a smaller competitor is of course frequently encountered.

In seeking this type of equity source, the small company would be well advised to seek the services of an intermediary in whom full confidence can be placed. As suggested earlier, the company's banker and other professional advisers would make a good starting point.

There is an increasing number of venture capital firms in Canada. Often they are owned by a consortium of banks, trust companies and other pools of capital. They specialize in investing in small companies seen to have strong growth potential through good management and product acceptance. Just as in the case of presenting a proposal for a term loan (F.B.D.B. Pamphlet No.3), it is essential to document the investment proposal to the source of venture capital whose staff are well trained and qualified in assessing every aspect of the proposition. This is a fundamental requirement which cannot be over-emphasized.

TYPES OF SHARES

Generally, equity capital is represented by two main forms of securities — preferred shares and common shares.

PREFERRED SHARES

As the name of this type of equity stock suggests, preferred shares usually command a stated dividend payment in preference to junior types of shares including common stock. Most often preferred stock carries no additional claim on earnings. Similar to having a first claim on dividends, preferred stock has a preference over any junior

shares in the liquidation, voluntary or forced, of the company. Voting privileges usually attach to preferred shares; often the share issue will grant certain additional privileges such as in the election of directors if a specified number of dividend payments has not been maintained.

Typically, preferred stock provides for restricting the actions of the common shareholders. For example, a restriction on the issuing of additional shares ranking equally with or ahead of the preferred without their consent; or on the assuming of debt beyond a specified amount or kind; or providing that the dividends on junior shares be payable only out of earnings made subsequent to the issuance of the preferred stock, and then perhaps only if the dividend payment does not reduce the company's working capital below a specified amount or below a stated ratio to the preferred stock.

In short, the preferred stockholder has the right to receive dividends only at the specified rate and the right, also, to certain asset protection if all does not go well with the company. Beyond these basic rights, the privileges and restrictions attaching to preferred shares are governed by the terms of the issue given in the prospectus.

There are too many variations in the provisions of an issue to include them in this short pamphlet. But two commonly encountered features should be mentioned.

The first is that many preferred share issues are "redeemable", meaning that the company specifically reserves the right to call in the stock and buy it back from the shareholders at a price usually set somewhere above "par" (or face) value, partly to compensate the stockholder for his trouble in being forced to seek another investment for his funds, but often partly for another reason. The redemption of preferred shares which often limit the actions of the holders of the common shares, cancels such restrictions, thus restoring freedom of action, and the desire for such freedom by the junior shareholders may cause them to set the share redemption price above par value. From this, a good general rule flows, namely, that <u>it is not advisable for a company to issue any form of securities, senior to the common stock, not redeemable by the company at will.</u>

The second frequently-found feature is "convertibility" which in a sense is the opposite of "redeemability", the latter being at the company's choice whereas the former

is at the stockholder's choice. Where an issue of preferred shares provides for convertibility, the stockholder may at his option convert his preferred stock to common; the most usual kind of conversion is almost always from a senior security to a junior issue.

Why would a company seek to issue preferred stock as against other securities?

Preferred stock is issued for any one or more of several reasons, such as: -

- To appeal as an investment to that class of investors who seek a security giving more income than bonds but with more certainty than is often found in common stock.
- To avoid the higher "fixed" charges usually associated with bonds.
- To avoid the possibility of foreclosure in case the fixed charges are not paid.
- To avoid difficulties that might arise in the issuance of bonds. (For example, the nature of the company's assets might make the mortgaging (i.e. pledging as security for the bonds) of them difficult or even impossible; if the assets are already pledged, a second charge against them would probably require a high interest rate; the company might not wish to mortgage its assets at the time but would prefer to reserve such strength; the prevailing conditions in the bond market might discourage an advantageous bond issue).
- To facilitate a merger or consolidation.
- To be used as a bonus in the sale of bonds or of common stock.
- To retain the status quo in the control of the common stock.

COMMON SHARES

Common shares, being equity capital, also represent the ownership of the company, but only after all senior claims have been satisfied including the preferred shares. Therefore, the owners of common shares are the first to suffer in the event of un-

successful operation. Conversely, they stand to benefit most from the company's success. They usually control the company; they elect the directors and do such other things as shareholders are permitted and required to do.

Most companies issue only one class of common stock. Sometimes a company may issue both voting and non-voting common shares, primarily for the purpose of concentrating control. As in the case of preferred shares, many variations in the provisions of an issue are possible.

CONCLUSIONS

The owner of a small business seeking additional equity capital should keep three key points in mind:

1. Plan carefully, thoroughly and for the long term.
2. Demonstrate to potential investors that management is competent and that prospects are good.
3. Convince prospective investors that the offer of an ownership interest is on terms at least as attractive as other investment opportunities open to them.

These essentials can in the first instance best be evidenced by presenting to potential investors accurate and comprehensive documentation as an intelligible portrayal of all the facts. The presentation should necessarily include the business' comparative balance sheets and operating statements for prior years. From their review the new investor can gauge past progress and assess future earnings, as well as sizing up the soundness of management's judgment. Even when seeking new capital from internal sources, such an analysis is beneficial. Any employee considering buying into the business should have this data made available to him.

Finally, most successful small companies reach the point where financial partners in the business should be invited. It is a major step on which sound advice is essential. The decision requires careful study and consideration.

CASE

Counselling Assistance to Small Enterprises

The Federal Business Development Bank's Management Counselling Services known as CASE (Counselling Assistance to Small Enterprises) assists small businesses in Canada to improve their methods of doing business.

Virtually any established business or anyone about to engage in a business enterprise can apply provided it has had prior discussion of its needs with its appropriate business advisor(s), and provided it has no more than seventy-five employees.

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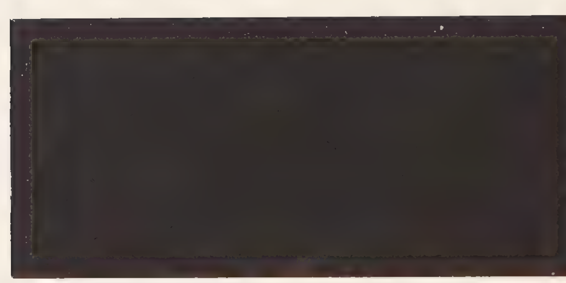
PAYING YOUR EMPLOYEES

Pamphlet No. 13



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PAYING YOUR EMPLOYEES

Pamphlet No. 13

FEDERAL BUSINESS DEVELOPMENT BANK
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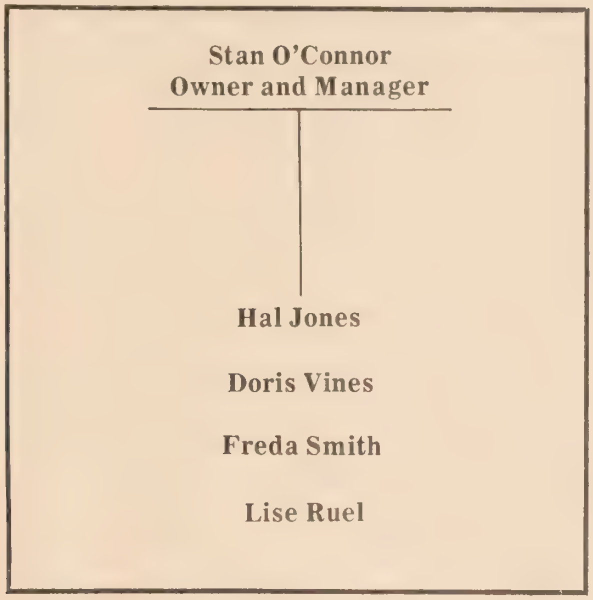
PAYING YOUR EMPLOYEES

PERSONNEL PEOPLE – WHO NEEDS THEM?

In a business like this —

O'CONNOR CLOTHES



— the job of managing staff is simpler than in a large corporation like this:

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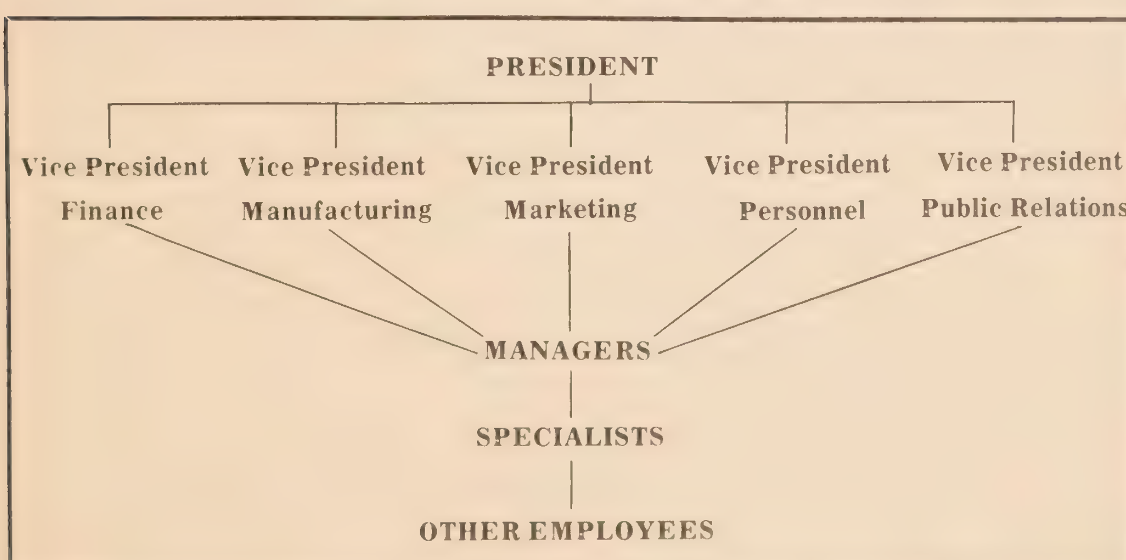


Personnel administration is a vitally important and complex job in large corporations. It involves such varied things as personnel policies, procedures, records, manpower planning, recruiting, training, performance evaluation, wage and salary administration, employee benefits, job enrichment, labour relations, labour legislation, employee publications. It should also include helping people with their everyday problems and fears, such as getting along with other people, moving, retiring. It affects the lives of large numbers of employees, and the way they do their work.

Personnel departments require specialists in interviewing, training, benefit plan administration, collective bargaining, writing, payroll management, and many other fields, even medicine in many cases.

Some personnel work is of a maintenance nature such as keeping records and recruiting. Other parts of personnel work, the more important parts, deal with the development of employees to perform their work better and approach their full potential. Such things as training, delegating, performance evaluation, morale building and motivating fall into this category.

How can Stan O'Connor, owner and manager of a small business with four other employees, hope to do all these things effectively? Luckily, he doesn't have to. Personnel administration in a small business is also vitally important, sometimes frustrating, and often neglected. But with the proper outlook and a few relatively simple techniques it can be very effective and rewarding. This pamphlet contains a few tips on personnel administration that may be useful to the manager of a smaller business, particularly relating to wages and salaries.

THE STARTING POINT – POLICIES

Whether you write them down, as a Personnel Department would do in a larger business, or try to keep them in your head, the personnel policies you wish to follow will determine what procedures and techniques you may need to carry them out. They can usually be stated fairly simply, so why not have them on record?

Let's try to state briefly a policy that might be followed by a small business in regard to wages and salaries:

O'Connor Clothes

> "Wages and Salaries: It is the policy of O'Connor Clothes to pay its employees the average of rates for similar work in this community, to comply with all applicable wage legislation such as minimum wage and vacation pay legislation and to review wages and individual performance at least once a year."

At first glance, these words might seem unnecessary, but note a few key words: "average of rates", "similar work", "comply with........minimum wage......legislation." O'Connor Clothes doesn't pay "higher than average" wages, it pays "average" wages, as a matter of policy. It doesn't necessarily pay as well as any employer in town, but it pays the average for clothing stores in town, as a matter of policy. It pays above the minimum wage and is committed to do this if the minimum wage increases, as a matter of policy. It considers raises, based on how well you do your job, at least once a year, as a matter of policy.

If Stan O'Connor chose this policy, and stated it in writing to his employees, it should be very reassuring to people like Hal Jones and Doris Vines. It should contribute in a small way to good employee relations; the absence of any stated policy could contribute in a big way to poor employee relations.

Similar brief policy statements could easily be chosen for other topics, for example, "Vacations", "Working Conditions", "Training" and "Promotions".

In a small business, employee relations are on a very personal basis. Personnel policy statements are one reflection of the owner's personal regard for his employees.

THE NEXT STEP – PROCEDURES

Having a stated policy on a topic such as Wages and Salaries simplifies the job of

describing how to carry out the policy, that is choosing the techniques. The example policy stated earlier suggests the need for several procedures, for example:

a) A Wage Survey Procedure — to establish at regular intervals "the average of rates for similar work in this community." Such a survey would indicate the ranges and averages of wages for the jobs surveyed.

b) A Wage Legislation Survey Procedure — to establish minimum wages and forthcoming changes to them, and to ascertain vacation pay requirements.

c) A Job Description for Each Job — a simple list of duties.

d) A Job Evaluation Procedure — to determine the relative value of each job might be considered, but is not likely to be necessary in a small business.

e) A Performance Appraisal Procedure — to review how well each employee does his job.

f) A Wage Revision Procedure — to determine changes to individuals' wages.

All of these procedures could be covered by a few brief statements and sample forms, as illustrated below.

O'Connor Clothes

Personnel Procedure No. 5

Wages and Salaries

1. Wage Survey: Each May a survey will be made to establish the prevailing rates for clothing store employees and other similar occupations in this community. Sources to be contacted will normally include the Board of Trade Annual Wage Survey, the provincial Department of Industry Survey and at least four local employers. Average rates and ranges will be calculated from the survey figures.

2. Wage Legislation: Regular contact will be maintained with the provincial labour relations authorities and the Canada Department of Labour to ensure compliance with the latest legislation regarding minimum wages, vacation pay and termination pay. (The Canada Department of Labour, Legislative Research Branch, Ottawa publishes minimum rates periodically for all provinces and territories, including pending changes in these rates. An example of this is shown in Appendix A for specific years.)
3. Job Descriptions: (These may not be vital to a small business, such as a store which employs, for example, three sales clerks and a cash register operator.) A one-page list of duties for each type of job will be maintained.
4. A Job Evaluation Procedure: The necessity for this also will depend on whether there is a large number of different jobs. Normally, with only three or four types of jobs they can be "ranked" quite accurately by the manager of the business, without requiring any formal comparison system such as a point system.
5. Performance Appraisal: A brief written report will be prepared on each employee's work record once a year, on the anniversary of his employment date. A report will also be prepared for new employees after their first six months of employment. The report will be discussed with the employee for the purpose of commending good work and pointing out areas that require improvement.
6. Wage Revision: A review of each employee's wages will normally be carried out in conjunction with every performance appraisal. It will give consideration also to other internal and external factors related to wage rates.

How would these procedures work in a very small business like O'Connor Clothes? Likely, quite well. In fact, some of them might be omitted.

Let's take the case of Doris Vines, Stan O'Connor's most experienced saleslady. Doris joined the business five years ago as a saleslady, having previously worked at Eaton's in the big shopping centre for two years. She is now paid $130 per week, or $6,760 per year. It is time for Stan O'Connor to review her performance during the past year, and her salary. How might he do this?

Since he is running his own business, with the help of only four employees, he might likely call Doris into his office and say,

"Doris, you've sure been a big help to me over the past year. I hear the girls at Eaton's got a raise, as you probably know. Also I'd like you to take charge of the work of the other girls from now on. So I'm giving you a raise of $20 a week."

It's all there: wage survey, job description, job evaluation, performance appraisal and wage revision.

In other words, Doris was given a raise based on good performance, increased responsibility and a change in prevailing rates in the wage market. Stan O'Connor was also aware from reading the booklet "Labour Standards in Canada" that he was complying with the law of the province in respect of her wages. ("Labour Standards in Canada", published by the Legislative Research Branch of the Canada Department of Labour. It summarizes federal, provincial and territorial legislation pertaining to minimum wages, hours of work, vacations and holidays, termination of employment, etc.)

WHY GIVE RAISES?

What are some of the factors to be considered when reviewing rates of pay? If you are running your own independent small business you may feel, naturally, that the main factor is whether the business can afford an increase in wages. If an increase in the payroll would likely cause the business to lose money permanently, there would be no logic to granting the increase. The business would soon cease to operate. Some of the other factors that affect the review of each individual case are also of an internal nature, such as:

- the basic skills and responsibilities of the employee, i.e. what job is involved
- the employee's work performance
- pay relationships within your business
- the overall salary budget provided for the year

There are also factors, external to your business, that may affect your consideration of each pay rate in your business. Some of these are:

- cost of living trends
- supply and demand for new employees

- rates of pay for similar jobs in other organizations
- wage indices and trends

All of these can exert pressure on the internal pay structure in your business. Because of these many factors, the administration of wages and salaries becomes very complex in businesses with large numbers of employees. The six main procedures used in wage and salary administration mentioned earlier can become quite extensive in such businesses.

WHO GETS A RAISE?

To recap, those six procedures are:

- Wage Surveys
- Wage Legislation Surveys
- Job Descriptions
- Job Evaluation
- Performance Appraisals
- Wage Revisions

We are listing these closely-related procedures in such detail in order to illustrate how the manager of a smaller business might short-cut some of them, depending on the number of employees, and the number of different jobs. It is likely that Stan O'Connor might carry it all in his head and give Doris Vines the verbal appraisal and advice of her pay increase that we quoted earlier.

But preferably, if he has a growing business, he would have a written record system for at least three of the procedures, i.e. job descriptions, performance appraisals and wage revisions.

The job description could be a fairly simple listing of the duties of each saleslady and cashier. It provides a convenient reference list for introducing new employees to each job and is helpful when duties have to be re-arranged. It's easier than saying the same things over and over again to every new employee.

The performance appraisal could initially be a written paragraph or two recording your opinion of an employee's work performance and your ideas of steps that you and the employee could take to improve that performance. As the number of employees

increases you may wish to make the appraisal more specific, as it will become impossible to compare a large number of people adequately without using some definite and objective measurements. There are thousands of different performance appraisal forms in use and they really have to be custom-designed by you for your own business. A performance report, when completed, should tell you, and the employee

- **WHETHER HIS JOB PERFORMANCE IS SATISFACTORY**
- **WHAT PARTS OF THE JOB ARE DONE BEST**
- **WHAT PARTS NEED IMPROVEMENT**
- **WHAT STEPS CAN BE TAKEN TO IMPROVE**

By covering these points, the report also indicates whether an employee is generally suited to the type of work, or might do better at something else.

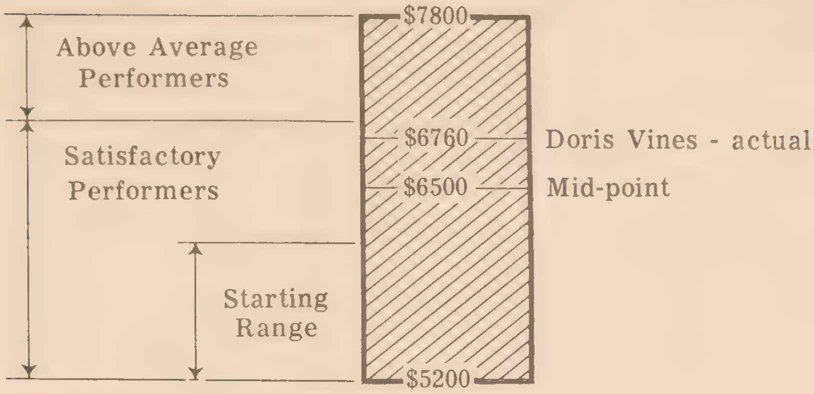
HOW BIG A RAISE?

How do you decide on the exact amount of an individual pay increase? First, you should get a general picture of the range paid for similar work by other employers, as well as within your own business. Some provincial governments publish salary surveys, some surveys are carried out by local groups in certain communities but chances are you'll have to do your own leg work.

Let's suppose that Stan O'Connor obtained figures on actual salaries paid to salesladies by five employers in his community, involving about twenty-five actual salaries. They ranged from $2.50 per hour to $150 per week; in all cases the work week was 40 hours. Stan converted these figures to annual salaries because all of his budget figures and other financial data were expressed as annual figures. This showed a range of $5200 to $7800 and a mid-point, or "half-way point" of $6500.

Stan interpreted this correctly as meaning that starting rates should be toward the bottom of this range, that those who did an average job would likely progress from the starting range to the middle of the range, and perhaps higher, and that salesladies who showed above-average performance should be paid toward the top of the range. He also understood that such a range would gradually change, likely upward, and that the whole range would need to be reviewed at least every year. In brief, he now had this picture:

SALESLADIES' SALARIES



Now, what about all the factors to be considered for Doris Vines? If she is to "take charge of the work of the other girls from now on", she will no longer be doing the same job as the other salesladies. She will have more responsibility and therefore should be paid more than salesladies. Stan added to her job description, or list of duties, three new items:

1. "Supervises the quantity and quality of work of all salesladies."
2. "Trains new salesladies."
3. "Reports to me on the work of all salesladies."

He also changed the job name, or classification, to Sales Supervisor.

As far as Doris' performance was concerned she was a first-class saleslady, well above average. Stan reasoned that based on her new responsibilities, performance, and comparisons with other employers her salary should be above the top of the range paid to salesladies, that is above $7800, by at least 5% to 10%. She had not received a pay increase for 12 months and during that time the Consumer Price Index had increased by 6%. Unemployment in the area had practically disappeared because of the opening of a new radio and television assembly plant. Stan realized that he needed Doris Vines on his staff badly, and even though she was already the highest paid of his salesladies, she should receive the promotion and pay increase.

He remembered that there were still other factors to consider. 5% above $7800 would be about $8200. This would be more than 21% above Doris' present rate of $6760. Stan

wondered what would happen if all his costs went up 21% per year. He certainly couldn't increase his prices that much. Yet Doris needed a 6% increase just to catch up part way with inflation. He realized income taxes would erode part of her increase, too. She had no experience in supervising, so was unproven in that aspect. For these reasons, Stan decided her salary should be increased above the salesladies' range, by 5% to 10%, in two steps, one now, and the second after a period of successful experience as a Sales Supervisor, in about six months. He decided that the first step should be to $7900, that is an increase of $1140 ($22 per week) on her present salary of $6760, or almost 17%. This seemed a very large percentage but it was a promotion and his salaries did seem to be getting behind a bit. In six months he would review her work as a Sales Supervisor, try to get a picture of prevailing rates for that job, and probably increase her salary to $8200 or higher.

SUMMARY

Some fairly simple personnel records and techniques may assist you in keeping track of such things as wages and salaries in a small business.

Written personnel records and procedures may seem unnecessary if you have only three or four employees. If these employees are changing frequently and if their numbers are increasing you will find it difficult to keep personnel records in your head. The answer may be to set up, while your staff is small, a written system of personnel policies, procedures and records that will be available and suitable as the number of staff grows.

In a small business the owner/manager will initially determine the policy to be followed in paying his employees. As the number of employees grows this may be done by collective bargaining.

Of six formal procedures normally associated with wage and salary administration, three may be particularly applicable to small businesses, i.e. job descriptions, performance appraisals, and wage revisions.

The factors, both internal and external, which affect rates of pay in a small business are similar to those related to larger corporations.

In considering changes to individual rates of pay it is usually prudent to give careful thought to all of these factors. In summary, the main factors are:

1. The ability of the business to pay increased wages
2. The basic job requirements
3. Internal pay relationships
4. Performance
5. Cost of living trends
6. Supply and demand for employees
7. Rates of pay in other organizations
8. Wage indices and trends.

The first four factors relate to your own business, the last four being external to your business. By considering each factor, it is possible, with the help of the three procedures described, to pay your employees equitably, to change rates of pay sensibly and promptly as required and to keep permanent, accurate records of the work and pay of each employee.

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Source: Canada Deptarment of Labour, Legislative Research Branch, Ottawa

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Minding your own business

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PERSONNEL RECORDS

Pamphlet No. 14

MANAGEMENT SERVICES

The Federal Business Development Bank provides financial and management services to new or existing businesses anywhere in Canada, particularly those of smaller size.

Helping to promote sound management practices in small businesses is an objective of the Bank's management services. As part of this program, FBDB is publishing this series of pamphlets. Copies may be obtained in English or French without charge from any FBDB office, or by mail using the Order Form in the back of this pamphlet.

PERSONNEL RECORDS
Pamphlet No. 14

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P.O. BOX 6021, MONTREAL, QUE. H3C 3C3

PERSONNEL RECORDS

A PLACE FOR EVERYTHING

F.B.D.B. Pamphlet No. 13, "Paying Your Employees", points out some of the complexities of personnel administration and illustrates how these can be simplified in a small business, particularly in the administration of wages and salaries. But this involves the setting up of a few basic records on work performance and pay. Personnel records are required for other purposes too, and they can all be tied together as a basic personnel records system for a small business.

If Stan O'Connor, the owner/manager of O'Connor Clothes, the small business depicted in Pamphlet No. 13, hadn't had any personnel records it might have been difficult for him to deal with a salary increase for his Sales Supervisor, Doris Vines. Maybe this would have happened:

> "Stan O'Connor fumbled through the files in his desk, trying to find his salary list. Doris Vines would be at his door any minute. He wanted to tell her about her raise, but what is she making now? Is it $130 a week, or is that Freda Smith? Or was that the 130 bathing suits we sold last week? Or was it 130 bow ties?
>
> Ah, there it is, in with the vacation schedule. And it shows that Doris' salary is $130 a week. Just in time, too.......'Good morning, Doris. I want to talk to you about your salary. Doris, you've sure been a big help.......'"

Wouldn't it be easier to take a few hours and set up a simple personnel records system?

THE BASIC RECORDS

General Files. Any personnel records system includes files on general subjects of interest, just like other records systems. File sections on such general topics as recruiting, training, manpower planning, salary administration, forecasts, budgets and benefit plans, with detailed titles of many individual files in each, are found in personnel departments everywhere. A small business, without such a department, simply requires fewer of them. It should be no trick for the manager to set up the general file topics he is interested in.

But personnel records also include some unique things, not found in other types of records. This is because certain of these records involve the privacy of individual employees. They should therefore be confidential. A good set of personnel records in a small business should include the following, in addition to whatever general files are desired:

A personal file for each employee, containing all documents and correspondence related to the employee from the time of applying for employment.

An employment record card (or sheet) for each employee, summarizing his personal data, education, work history, and his job and wage record. When his job, location or wage rate change, this record has to be updated. The record can be kept on cards in a file box, but there are advantages to having all or most of each employee's records in one place. So design an 8½'' x 11'' sheet for this purpose and file it in each employee's personal file, all by itself on the left side of the file, where it is in full view any time you open a file. In designing such a sheet, or any type of personnel record for that matter, it is useful to keep in mind the four main ''changes of status'' which may occur during a person's employment. An employee may

- START EMPLOYMENT
- CHANGE DUTIES
- RELOCATE WITHIN YOUR ORGANIZATION
- STOP EMPLOYMENT (resign, retire or be terminated)

In other words, on any day your records system should show accurately and quickly how many employees you have, who they are, what job each has and where each is located. If it does this, such things as salary records, training records and so on will fit smoothly into the system. Obviously, it is easy to keep such information accurate and up-to-date if you only have five employees at one location. It becomes somewhat more difficult if you have fifteen permanent and six temporary employees at two locations, as well as a high rate of staff turnover. As your business grows even larger you have to become more dependent on the accuracy of written records, so why not set up a good, simple, workable system of personnel records while your business is relatively small?

Here's an example of the type of employment record sheet that might suit your needs:

O'CONNOR CLOTHES

Employment Record

Name.. Date of birth......................Sex.......
Surname Given
Date employed................................ Marital status.....No. of children...........
Job.. Starting Rate $................

Education Work History

Date	Job Classification	Location	Wage/Salary	Remarks

So far, then, that really only amounts to one basic, and very important item in the records system, other than general files, a personal file for each employee, including an employment record sheet. You may also wish to have a photograph of each employee in the personal files, for various reasons such as security, or to help you learn who your employees are.

A Payroll and Deductions Record. Almost 80% of the over 400,000 businesses in Canada in 1974 had less than 10 employees. This size of staff lends itself to a fairly simple, inexpensive payroll records system. In fact some small businesses find that the most appropriate method for them is to have another firm look after their payroll. Some accounting firms, banks and bookkeeping firms provide such services very efficiently to a large clientele of businesses.

Because of the variety of payroll forms and records available, no attempt will be made here to suggest such details for your business. Some of the main objectives of your payroll records system are:

a) to calculate the gross pay (regular and overtime), for each employee before the end of each pay period, the deductions to be made by the employer, as required by law (e.g. employee income tax instalments) or by the authorization of the employee (e.g. employee contributions to a savings plan or charity fund), and the net pay.
b) to pay each employee his net pay at the end of each pay period (e.g. every two weeks or twice monthly).
c) to maintain a continuous, permanent record of all payroll transactions, including individual changes in pay rates.

The most common payroll deductions encountered by Canadian employers are:

- Income tax instalments (federal and Quebec)
- Government pension plan contributions (federal and Quebec)
- Contributions to employer's pension plan
- Unemployment insurance premiums

- Contributions to group life insurance plans
- Contributions to medical insurance plans
- Union dues
- Payroll savings plans
- Contributions to charity appeals

Your payroll records will have to systematically keep track of the deductions applicable to your business. You may wish to include in your system a summary sheet, to be completed monthly, quarterly or at any interval you prefer. This would simply show you at a glance the current salary of all employees. It would be of particular interest when comparisons are being made in preparation for granting salary increases.

Records of Individual Performance. In Pamphlet No. 13 we described briefly what procedures and records might be used in a small business to evaluate work performance as one of the factors that determines rates of pay. It was concluded that in a business with very few employees, job descriptions, if needed at all, can normally be confined to a one-page list of duties. These might be kept in a general file titled "Job Descriptions", with a copy of the relevant job description in each employee's personal file.

Also, a performance report is advisable, even with a few employees, so a simple form is required for this. Again, a completed performance report would be filed in the personal file of the employee reported on. The purposes and format of this form are discussed in Pamphlet No. 13.

Application for Employment Forms. Smaller businesses frequently don't ask people to fill out an application when they apply for a job. They simply decide on the spot to hire an applicant, particularly if the job is quite junior. The result is, of course, that there is no record of an employee's background so the records system is incomplete.

If you have, or expect to have several employees, if their numbers are likely to grow and if there will be some turnover, it is almost inevitable that many occasions will arise when you will need certain information from the background of some of your employees. The normal way of obtaining and recording this is to have each employee complete an application form before he is hired. This form is then kept in the person's file. Its format is not difficult to design and there are thousands of examples in use. It should cover three general areas: personal data, education and work history. It might also ask

questions about particular skills, personal aspirations or attitudes and it usually requests names of references.

It must not contain questions that contravene the fair employment practices legislation in effect. Such legislation commonly forbids discussion of an employment applicant's religion, age, colour or race.

CHANGES TO YOUR RECORDS

It is largely a waste of time and effort to keep records unless they are kept right up to date. When Stan O'Connor tells Doris Vines about her increase in salary and promotion to Sales Supervisor, that's one thing. The next step is for him to plug those changes into his personnel records, immediately! Not next month, or next week, or tomorrow, but right now! Today! If you don't intend to follow that concept of timing for changes to personnel records, forget the idea of a records system. If you don't enter changes immediately, all you will have is a set of historical records that show a person's salary, job, location, etc. at a time that isn't of primary interest, the past. What you want to know about is today, and in the future. Otherwise you wouldn't likely be looking in that person's file today. Information about the past will always be there in your records system, in ever-growing amounts if you need it at any time.

How can you be sure that all changes are made to your personnel records, and that they are made immediately? We referred earlier to four main "changes of status". An employee may:

- START EMPLOYMENT
- CHANGE DUTIES
- RELOCATE
- STOP EMPLOYMENT (resign, retire or be terminated)

Many large employers use a formal "Change of Status" card, or form, to advise their personnel records section immediately of all such changes. Such a form is quite simple, requiring only the entering of the employee's name and the ticking off of the appropriate pre-printed items.

In a smaller business, this could also be useful. But the more important aspect is to have someone responsible for making the changes, immediately. This person should be completely familiar with the personnel records system and aware of the importance of it being up-to-date. This person may have to be you, initially, or perhaps your secretary.

An alternative method of effecting the changes, not requiring a change of status card, is for that person to enter the changes directly on the records that we have already discussed. Doris Vines' change in salary and position would require a new entry on her Employment Record, showing the effective date, her new job classification and her new salary. It would also require a new entry in the payroll records.

THIS FILE WILL SELF-DESTRUCT IN 5 YEARS

What should you do with personnel records that you no longer need? Destroy them, when you are convinced you no longer need them. When an employee becomes a former employee it is normal for his personal file to be separated to an "inactive" section of the filing system, reserved for former employees. It should not be destroyed immediately for many reasons, such as requests for references, year-end income tax returns, enquiries from the former employee, etc. But it should not be kept forever, either. Perhaps your system should require that files of former employees be destroyed after two years, or even five years. That's for you to decide.

Job applicant files are another example. If you interview fifteen applicants for one job, you will likely have fourteen files that aren't of long-term interest. They will contain your interview notes, application forms and possibly reference letters or other material submitted by these applicants. Some of this material may have to be mailed back to the applicants. Also you may wish to consider some of these applicants for other jobs in the future. But again, there will come a time perhaps in six months or a year when those files will be of no use to you. Your system should provide for their destruction after that selected time interval.

EVERYTHING IN ITS PLACE

A few basic personnel records are essential in a business, even one with very few employees.

A basic personnel records system in a small business could consist of the following:

GENERAL FILES	—	on topics of your choice, related to personnel administration, such as recruiting, training, manpower planning, budgets, benefit plans, etc.
PERSONAL FILES	—	a confidential file for each employee, containing all documents and correspondence related to that employee.
EMPLOYMENT RECORD SHEET	—	showing the historical and current status of each employee, filed on the left side of the personal file.
PAYROLL AND DEDUCTION RECORDS	—	recording all payroll transactions and changes in pay rates.
JOB DESCRIPTIONS	—	a brief list of duties of each job classification in the business.
PERFORMANCE REPORT	—	completed on each employee, at least annually, giving your review of their job performance.
APPLICATION FOR EMPLOYMENT	—	a form for this is desirable, providing a written record of the background and qualifications of applicants.
CHANGE OF STATUS FORM	—	or equivalent method of entering changes immediately into your personnel records system.

A simple, well maintained personnel records system will save you time by telling you quickly the current status of all your employees.

When a particular personnel file or record is no longer required, it should be destroyed. Your records system should specify a particular retention period for any records that periodically become redundant, such as files of former employees.

Personnel records contain private information about people. It is your responsibility to safeguard that privacy by restricting access to those records to a small number of persons who will respect the confidentiality.

CASE

Counselling Assistance to Small Enterprises

The Federal Business Development Bank's Management Counselling Services known as CASE (Counselling Assistance to Small Enterprises) assists small businesses in Canada to improve their methods of doing business.

Virtually any established business or anyone about to engage in a business enterprise can apply provided it has had prior discussion of its needs with its appropriate business advisor(s), and provided it has no more than seventy-five employees.

This service is provided at a moderate fee and supplements counselling services obtainable from the private sector. The counselling is performed by retired business persons selected for their management experience.

To obtain more details on CASE, contact any of the CASE offices listed below or any FBDB branch office.

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CORNER BROOK	Third Floor, 4A Herald Ave.	(709) 639-9126
HALIFAX	Suite 914, Cogswell Tower	(902) 426-2474
MONCTON	860, Main St., Suite 702	(506) 858-2973
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Minding your own business

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PLANNING THE START OF YOUR RETAIL BUSINESS

Pamphlet No. 15

[redacted]

The Federal Business Development Bank provides financial and management services to new or existing businesses anywhere in Canada, particularly those of smaller size.

Helping to promote sound management practices in small businesses is an objective of the Bank's management services. As part of this program, FBDB is publishing this series of pamphlets. Copies may be obtained in English or French without charge from any FBDB office, or by mail using the Order Form in the back of this pamphlet.

PLANNING THE START OF YOUR RETAIL BUSINESS

Pamphlet No. 15

FEDERAL BUSINESS DEVELOPMENT BANK
P.O. BOX 6021, MONTREAL, QUE. H3C 3C3

Why do you want to be in business? Think about that question. While you can have many reasons for going into a business of your own, your one aim is success.

Planning the start of your retail business

Foreword

Why plan the start of your retail business?

The difference between a successful retailing concern and one that fails is good management. Good management begins before you start your retail business. In other words, the start of your retail business must not just happen. It must be well planned beforehand.

It is far wiser to foresee problems and adjust for them at the planning stages than to suddenly be forced to react when your alternatives or capital may be limited.

This booklet is an introduction to various aspects of good management when planning a retail business. Use this booklet as a guide whether you are just thinking about a retail business of your own or have already made commitments towards having a business.

Part one
How to get started

i. Buy an existing retail business:

The advantages

Buying an existing retail business provides you with a number of advantages that are part of the purchase package.

It's the quickest way of "being in business" by allowing you to make immediate cash sales to an established clientele. The business will have established lines of credit both with its customers and suppliers. It will also have established lines of supply for the products being sold.

If the business is large enough to have employees and they remain, this means you have staff experienced with the business. The vendor himself should be able to pass on direct experience of the business to you.

More importantly, an existing business has a proven business history which reduces the uncertainty of a retail venture. This permits you, when purchasing the business, to assess both the actual and potential of the venture. A proven business record may also make it easier for the buyer to obtain financing as the lender then is not basing the loan risk solely on forecasts that he could think are overly optimistic.

The disadvantages

Buying an existing retail business can also bring a number of distinct disadvantages.

The first disadvantage is that you are "stuck" with the location of the business. The location may have originally been chosen for specific market conditions that no longer apply. The location could be in a section of town that has become run-down, or has been superseded by a new shopping centre, or serves a neighborhood no longer affluent or now less populated.

Facilities, image and business policies which are part of the purchase package can be difficult to change. Changes to the facilities can mean additional costs and also loss of revenue should the business have to close for the alterations. The image of the business is probably well established; but is it the image that you want your business to have? How many customers associate with the present image and how many would you lose by changing to a new image? Established

business policies (customer credit, refunds, deliveries, etc.) may not be compatible with your "style of business" or profit plan.

You will probably be charged for goodwill (the present value of business potential that represents established customers and store reputation). Goodwill and its dollar value may be difficult to determine.

Before buying an existing business, you must make a complete analysis with a lot of questions such as:

- Why is the owner really selling?
- What is the real physical condition of the building and facilities?
- How accurate and complete are the business records?
- Are all the accounts payable recorded?
- Are there any contingent or hidden liabilities?
- What about the accounts receivable; any bad debts?
- Have you counted the inventory? Have you evaluated it and checked for slow moving items?

ii. Start a New retail business:

The advantages

Freedom to do what you want is the major advantage in starting your own business from scratch. You decide what you want to sell, how you want to sell, and where and when. You set your own "style" of business without any restrictions of an existing set-up (existing facilities, image, policies).

Developing at your own rate is another advantage, especially if capital is limited and you must go step by step. An example of this would be the carrying of a smaller line of goods that would be expanded only as capital is built up. An existing business with an established large line of goods may put an excessive demand on your initial capital causing you to drop certain items. This can give you a business in trouble image and effect your revenues. Customers familiar with the existing line of goods and seeing them decrease may go to a competitor who carries both the dropped items and those you are still selling.

The disadvantages

Of course there are also disadvantages to starting a new business instead of buying an existing one.

The first disadvantage is start-up time. This means there is going to be an outlay of money that, until you are operative, will not be offset by any revenues. Starting from scratch means that almost everything must begin (examples: layout of facilities, inventory purchase, employee hiring, market strategy, pricing strategy, establishing of supply and credit lines) before the first sale is rung up on the cash register.

The second disadvantage is that you must establish your clientele. That means your marketing strategy must work. How soon and how well it works dictates the amount of your sales; especially in the beginning when you have yet to build up your own goodwill.

The third disadvantage in starting from scratch is the higher risk and the uncertainty particularly when you are trying to prove your case for outside financing.

"Making a go of it" with a new business is, initially, strictly in the future. There is no proven past where mistakes have been made and corrected, where you know your goods will definitely sell, where you really do know that you can make money out of your venture. It's conjecture; but based, hopefully, on a realistic forecast.

Whether purchasing an existing business or starting a new business from scratch, it is always advisable to consult both with a qualified accountant and a business lawyer. The accountant will be in a position to assist and advise you in analyzing the business. The business lawyer can check existing titles, liens, etc. as well as advise you on all legal transactions of your business.

Starting a New Business	Buying an Existing Business
• freedom of choice location	• location may be good or bad-analyze
• set your own "style" of business-no existing restrictions of image and policy	• lines of credit and supply established with customers and suppliers; vendor and employees can pass on experience
• develop at your own rate, especially when capital is limited	• purchasing total business-must analyze all aspects of business; goodwill charge
• slow start-up time	• in business right away
• initial outlay of money before operative	• immediate cash sales to established clientele
• higher risk and uncertainty	• proven business history
• financing can be more difficult	• financing easier when based on past performance and security

Part two
What to sell and why

The idea for most retail businesses is built around a particular product or line of products. Of course there are those who put the "being in business" idea first, and only fit in the "What will I sell" afterwards. Either way, you must give serious thought to what you are going to sell and why.

Your retail experience

Before choosing a product or line you must be honest with yourself as to what retail experience you have. This is applicable both in a general sense and specifically to the product that you are going to sell. Many people have found out, when it is too late, that there is more to selling than just attaching a price tag.

If you are short on retail experience, then find out first all you can about it. There are many publications available that can give you an insight to retailing. Some community colleges give courses in starting and managing small businesses. In addition, you can visit and observe retail establishments. Maybe an acquaintance owns or works in a retail business and is willing to talk about it.

Analyze why you frequent a particular store and not another. Are layout, courtesy, prices, number, and style of lines factors? If so, would you handle them the same way?

You may have retail experience, but is this experience directly related to the product you are going to sell? Whether in your own locality or further afield, visit shops that sell this product. Observe and ask questions.

If you do not have retail experience or retail experience in a specific line (e.g., hardware) you may wish to consider working in a shop similar to the one you are planning. A period of about six months would allow you to gain experience.

The product

With the product or line itself there are a number of questions you must ask. Questions such as : Where do I get the product from and will it be available on a continuous basis? Is there a warranty if the product breaks? Do I service the product? Do I deliver? Is it a complicated and difficult product to use? Do I assemble the product myself before selling it?

The financial aspect of a product or product line must also be considered. Is it an expensive item and one that customers will hesitate before buying? Is it a cheap item that you will have to sell many of to make money? If so, can you buy it in bulk?

Is your product seasonal or just popular at certain times? If so, what are you going to sell during the rest of the year?

Is the product just a novelty? Is it a "cute gimmick," fashionable only for the moment? Maybe you can take advantage of the novelty aspect, but what happens afterwards?

Really, why have you chosen the product you are going to sell? Familiar with it? This might be good, but don't let personal preference be the overriding reason for selling a particular item. You may like fluorescent painted plastic Bavarian cuckoo clocks; but there may be few, if any, potential customers who share your enthusiasm.

A lot of questions; but, help in both determining and justifying your choice of product or product line, is included in our next topic-- researching the market.

Part three
Your market

Your market research can be summed up as an estimate of demand. More simply, it can be expressed as finding out how many people want what you are going to sell.

In finding that out you will have to answer a number of questions such as : Who are these people? What are their lifestyles? What are their buying habits? Where are these people? How do I reach them?

Categorize your business

The first step is to categorize your business. Maybe it's hardware, crafts, furniture, clothing, sporting goods or whatever. Then find out the size of the total market in your area for that category. Your area may be a city, a locality or a province, depending on how far afield you plan to sell.

What are the total sales for this area? Are there significant trends? Are projections available? How many businesses are there in your category sharing the sales? Answers to these questions will give you an overlook of the total market.

Your geographic area

The second step is to identify and analyze the geographic area to be served by your business. Since customers usually go to the most convenient and closest place, travel distance may determine the size of your market area.

The third step is to find out all you can about the people in your geographic area. The information you should find is: present size and residents, average family size, age distribution, money available to spend, special buying attitudes, and comparison to other areas.

List your competitors

In conjunction with these three steps you should list all the competitors in your geographic area and try to assess what their "take" is in relation to the total sales. The yellow pages of your telephone directory can provide an initial listing of your competitors.

The analysis

A careful analysis of all this information, obtained in steps one to three and in the list of competitors, will go a long way in enabling you to determine: (1) if there's a market for your product or product lines; (2) what you can realistically expect is your share of the market (market target); and (3) what you can forecast as your sales.

NOTE: For sources in your market research see PART SEVEN-- Sources of Retail Information

Part four
Select your location

Careful study must be given to choosing the actual location of your retail business. Where you locate requires the same amount of consideration as choosing the geographic area to be served.

Too often business locations are decided upon by considerations other than the business potential. Saying a location is a "good deal" or the "price was a bargain" or "it's close to home" or "the place was ready to move in" should not be the sole factors that decide your business location.

Accessibility, visibility, and exposure to the customer usually are your most important considerations. The optimum location should combine the business potential along with your personal aims which can include the "close to home" factor. But remember that the business potential is more important.

The choices of where to locate your business are usually: downtown business district; suburban location (major and secondary shopping centres); and neighborhood location (city or suburban).

Downtown business district

The advantage of you locating in the downtown business district is the immediate availability of potential customers, those working in office buildings or shopping downtown. A central location like this allows you initial exposure to a greater number of people than you could normally acquire in the same period of time through building up goodwill.

While the large number of potential customers can be an advantage in one case, this can also be a disadvantage in other cases. Most central business districts are limited in parking facilities and heavy vehicle congestion may be a

deterrent to shoppers. Generally the larger retail stores are also located in the downtown business district which means stiff competition to a small business. A downtown business section, if alive, will affect you by location demand which translates into rentals and high operating costs.

Additionally, when deciding to locate in a downtown business district you must look carefully at the current phenomenon of urban decay. Is the downtown business district "still alive" after the offices close, or does everyone go home to the suburbs? Are there any shopping centres in your geographic area that are effectively drawing away shoppers, especially in the evenings and on Saturdays? Stores often changing ownership can be an indicator of urban decay.

Major shopping centre

A major shopping centre offers you the benefits of a downtown business district plus accessibility and parking facilities. You also know that a major shopping centre has been established as a result of considerable market research both to the present and future (new or growing suburbs). Many shopping centres have pooled-advertising for the centre as a unit; such as special days, sidewalk sales, etc.

Limited availability of premises, high rents, and concentrated competition are some of the disadvantages to a major shopping centre.

Secondary shopping centre

The secondary shopping centre has the same advantages and disadvantages as the major centre, but on a smaller scale. One benefit, in particular, that will be less is the drawing ability of the neighboring stores in the centre. Less stores will mean less people that you can count on as "walk-ins" into your shop.

Neighborhood location

A neighborhood location means you are limiting your business to a specific area of people. You must be very sure that there is a market in this neighborhood for what you are selling. Light drawing power and usually poor parking facilities are disadvantages that may not be offset by low operating costs and low rentals. Most neighborhood stores, usually within walking distance of customers, are small convenience outlets.

When evaluating a location, consider:

- Accessibility and convenience for customers
- Compatibility of your business with surrounding area
- Occupancy costs (including alterations)
- Visibility (Frontage) of your business and products
- Store exterior compatible with your image
- Store interior functional for your business and products

Part five
What will it cost?

You have decided to be in business for yourself. You have analyzed your market. You know your product. You've chosen your location. Now, you must establish what this venture will cost you. Determining your financial needs is probably your most crucial exercise in planning the start-up of your retail business.

A qualified accountant can help determine your financial needs as well as plan the setting up of a practical accounting system.

Usually, your starting costs will consist of the following items:

Capital Expenditures
- Improvements: painting and decorating, partitions, electrical, plumbing
- Fixtures: lighting, counters and shelving, sign
- Equipment: cash register, etc.

Opening Costs
- lease deposit
- licences, utility and tax
- deposits
- accounting and legal fees
- accounting system and forms
- stationery and office supplies
- advertising and publicity
- insurance
- wrapping materials

Inventory
- initial inventory
- reorder reserve

Contingencies
- unplanned expenses always arise. Allow 10% to 20% of planned expenses

Reserve Fund
- 2 to 3 months minimum of overhead costs and salaries to cover the possible lack of profitability during initial period. (Some businesses require a larger reserve, some less).

The above reflects the situation of a new business in rented premises. It does not consider the purchase of property and its related costs, nor does it reflect the goodwill charge if you had purchased an existing business. Also, the equipment is shown as a purchase requiring a cash outlay; leasing has not been considered. When trying to limit your initial cash outlay, leasing-- monthly payments-- might be preferable to an outright purchase.

Some additional points to consider include the fact that, initially, until you have proved yourself, your suppliers may insist that all inventory purchases be on a C.O.D. or deposit basis. This will mean the requirement of ready cash. Depending on your product line, if you are starting your business in late autumn you could require a larger opening inventory in view of the proximity to the Christmas buying season.

Part of determining your financial needs (especially in the calculation of Initial Operating Costs and a Reserve Fund) should include the preparation of a forecast and a cash-flow.

Forecast

Forecasting is the estimating of revenue, expenses and profit for a given period of time in the future. The forecast is usually prepared for the first year of operation and gives you the opportunity to assess the new business venture. Your assessment will test both the viability of a new venture as well as show up any weaknesses or shortcomings. Foreseeing problems and adjusting for them at the planning stages is far wiser than suddenly being forced to react when your alternatives or capital may be limited.

If you have purchased an existing business, the past years' records can provide meaningful data upon which to reflect any changes that you plan.

The new business, on the other hand, will have no past records. It is therefore all the more important that your estimates of sales, expenses, and profit be realistic. Errors, if any, should be on the conservative side, for it is better, when estimating sales, to be under; and over, when estimating expenses.

Simply illustrated, a forecast estimates the following:

	$
Sales	100,000
less: Cost of Goods Sold	60,000
equals: Gross Margin	40,000
less: Operating Expenses	30,000
equals: Profit	10,000

Your forecast for Sales will be the result of translating your market target (PART THREE of this pamphlet) into a sales figure. This dollar figure will be based primarily on competition oriented pricing. In other words, the selling price of your product would normally be set by what your competitors are charging for the same or similar product.

Your pricing strategy should also include such concepts as cost plus mark-up, market demand, competitors' prices, psychological pricing, and units to break even.

If your product is a high priced item, you can determine your Sales figure by multiplying the number of items you estimate to sell by the selling price. If you are going to carry a large number of products, with a low price, your Sales figure will be determined on a volume basis. In all cases, you may have to determine your Sales based on a percentage estimate of your share of the market.

Forecasting Cost of Goods Sold is the determining of the cost of the products that you will sell during a given period of time (in direct relationship to your forecasted sales). Again, if your product is a high priced item, multiplying the costs of the product by the number of items to be sold will give you your Cost of Goods Sold.

For low priced items, the calculation is usually as follows:

	$
Beginning Inventory (1st day of period)	4,000
plus: Purchases (during the period)	7,000
equals: Goods Available for Sale	11,000
less: Ending Inventory (last day of period)	5,000
equals: Cost of Goods Sold	6,000

The answer, Cost of Goods Sold, subtracted from your Sales, will give you Gross Margin.

To forecast Operating Expenses, you will identify your selling, administrative and general expenses; e.g., those expenses that are incurred in the daily running of your retail business. (Depreciation of fixed assets such as fixtures and equipment is an Operating Expense; but the purchase cost of these fixed assets is not.) Subtracting your Operating Expenses from Gross Margin will give you the estimated Profit for your business.

Ideally, your forecast would not only be done for a year, but also on a quarterly or monthly basis. This can be advantageous in seeing where your "lean" periods may occur.

Cash flow

Cash flow (sometimes known as cash forecast or cash budget) if done realistically, will show you, on a month to month basis, what cash you estimate to receive, what cash you will have to pay out and where you may have cash surpluses or shortages. It is advisable to have qualified assistance in the preparation of your cash flow.

If you give credit to your customers you will have to reflect in your forecast when your accounts receivable will generate cash in. Sales paid by most credit cards are treated as immediate cash from sales.

Illustrated simply, is a cash flow for a business's first three months of proposed operations.

The following assumptions have been made:

a) Sales are $6,000 in the first month, $8,000 in the second month, and $8,000 in the third month;

b) Cost of Goods Sold is 67% of Sales;

c) Approximately 1/3 of Sales are on credit. Terms are net 30 on Sales;

d) A $9,000 term loan has been obtained from a financial institution to purchase fixed assets;

e) The owners have invested $10,000 into the business;

f) Inventory purchases are on a 30 day credit.

	1st month $	2nd month $	3rd month $
Add Cash Receipts:			
Term Loan Proceeds	9,000	-	-
Owners' Share Capital	10,000	-	-
Cash from Sales	4,000	5,000	5,000
Cash from Receivables	-	2,000	3,000
Total Receipts	23,000	7,000	8,000
Less Disbursements:			
Improvements	4,000	-	-
Fixtures	5,000	-	-
Equipment	2,500	-	-
Inventory	4,000	5,000	5,000
Rent (incl. deposit)	1,500	500	500
Heat, Light & Power	300	300	300
Wages & Taxes	850	1,000	1,000
Advertising	300	200	250
Office Expenses	300	200	200
Insurance	500	-	-
Term Loan Repayment	-	300	300
Total Disbursements	19,250	7,500	7,550
Cash Surplus (Shortage)	3,750	(500)	450
Cash on Hand:			
Beginning of Month	-	3,750	3,250
End of Month	3,750	3,250	3,700

Sources of capital

After determining your financial needs, the next step is to find the money. The sources of capital needed to start a retail business generally are as follows:

- Personal savings
- Loans from family or friends
- Partner's investment or share-capital (if incorporated)
- Loans from financial institutions
- Trade credit from your suppliers
- Loan from owner if you buy an existing business.

Planning and presentation

The financing of your project must be well planned. For once you have committed yourself to your new business, an unexpected, and unprovided, requirement for cash can mean cutbacks or possible disaster. Before you start in business, you must know what you financial limitations are and set realistic goals. For when you are in business, you do not want to suddenly face a reality that bears little resemblance to your optimism.

When you are going to other people for capital or for credit, a good presentation (summary of starting capital needs, forecast, cash flow) based on realistic research goes a long way towards demonstrating the viability of your venture. A good presentation and a realistic research proves also to you that your venture is viable.

In conjunction with this part, What will it Cost?, you are referred to a number of previous "Minding Your Own Business" pamphlets:

No. 4 Forecasting for an existing business
No. 6 Forecasting for a new business
No. 9 Working Capital
No. 3 Presenting your case for a term loan
No. 8 Managing your cash

Part six
Business regulations

This section, unlike the others in this booklet, is not an introduction; but instead, is a warning.

As a business operator you will be faced with certain legal obligations to municipal, provincial and federal governments. The regulations are many and varied; all dependent on your type of business, the product, and your location.

You are strongly advised to make sure that you know all the regulations that will be applicable to your business in your particular city/town and province prior to actually starting your business.

Your lawyer and accountant will be in a position to advise you on these regulations. Chambers of Commerce, local business associations and fellow businessmen can, in general terms, indicate to you what regulations are applicable.

The following indicate the type of regulations affecting the retailer from three levels of government:

Municipal

- City Business Permit
- Zoning By-laws (opening hours and location)
- Land Use Regulations
- Business Taxes
- Property Taxes

- School Taxes
- Water Taxes
- Building Permits (applicable to alterations also)
- Building Codes (plumbing, electrical, fire and health hazards)

Provincial
- Business Registration (proprietorship under another name and partnership)
- Bulk Sales
- Incorporation (provincial charter)
- Land Use Regulations (certain provinces)
- Provincial Business Licence
- Provincial Corporation Income Tax
- Quebec Place of Business Tax (Quebec only)
- Provincial Sales Tax
- Provincial Building Codes (electrical apparatus and equipment, fire and health hazards)
- Minimum Age for Employment
- Minimum Wage for Employment
- Hours of Employment
- Annual Vacations and Public Holidays
- Workmen's Compensation
- Quebec Pension Plan (Quebec only)
- Safety and Health
- Provincial Health Insurance
- Maternity Leave
- Termination of Employment
- Payroll Tax Deductions (monthly remittances to government)

Federal
- Incorporation (federal charter)
- Federal Corporation Income Tax
- Federal Sales Tax
- Export/Import Permit
- Customs Duties
- Building Codes
- Industrial Health and Safety
- Unemployment Insurance
- Canada Pension Plan (except Quebec)
- Payroll Tax Deductions (monthly remittances to government)
- Trademarks
- Copyrights
- Industrial Designs
- Patents
- Product Safety
- Combines Investigation (includes false advertising)

To get an idea of how these regulations really do affect the retail business, see PART EIGHT-- CHECKLIST.

Part seven
Sources of retail information

PART THREE which introduced market research gave you a lot of "find outs". But where do you find out the statistics and information that you need?

Your own knowledge of the area and that of others is your initial source. If you are locating your business in an area that you are familiar with, you will be able to draw upon your own knowledge and that of people you know. Even if you are a newcomer to a specific area, just talking to people (shopkeepers,

neighbors, etc.) with the idea of finding out certain information can bring results.

Visiting shops similar to the one you are planning may allow you to learn the up-to-date situation of that type of business. This can be especially true when visiting a shop in a non-competitive location to your planned shop where the owner or manager may be willing to talk openly about the business to you.

Chambers of Commerce and local business associations are also prime sources of information. Most areas have service clubs (Kiwanis, Lions, Rotary, etc.) that have large memberships of business people that can provide valuable contacts.

Statistics Canada, Canada's central statistical agency, is your prime source for compiled information. Statistics collected, from government, business, and individuals, range from national aggregates to small area data covering only a few blocks of a single municipality, and from broad economic studies to specific matters. Data is published monthly, quarterly and annually, depending on the topic. Statistics Canada, as well as advising you of what information is available and how it might best be utilized, can also give you data actually keyed to your specific needs.

Government Departments, both Federal and Provincial, are valuable sources of information. A number of these include the Federal and Provincial Departments of Industry, Trade and Commerce; the Technical Information Service (TIS) of the National Research Council; the Department of Regional Economic Expansion (DREE); and the Provincial Development Corporations. Many government departments have information divisions available to you (e.g., Canada Post has data available as detailed as giving names, mailing addresses, occupations and language preference-- French/English-- of householders served through post offices).

By contacting the Federal Business Development Bank (FBDB), you can find out what government information services are available to meet your needs. Books and pamphlets on retailing are available at each of the FBDB's branches. The FBDB also provides a counselling service (CASE: Counselling Assistance to Small Enterprises) that can assist you in planning your business.

Your municipal government (City Hall) is another source not to be overlooked. Information on by-laws, zones, development plans, etc., as well as statistics; all applicable to the municipality, are available for your research.

Advertising agencies and direct mail firms, can, at a fee, supply you with market data and survey information.

Libraries can also be a source of retail information or put you in contact, via inter-library loans, with libraries specializing in economics, business, banking, etc.

Trade associations, retail associations and their publications can provide you with assistance and information. Membership usually is a requirement. Your library or Chamber of Commerce should be able to direct you to the nearest contact.

Suppliers can be a good source of general sales data and of merchandising information in your area. Because the sales representatives of the supplier probably serve other businesses and your competitors, you can obtain valuable information on the "current scene".

There are other sources of retail information beyond what we have listed. But remember, information will not come to you, you must look for it. Asking questions of people is the easiest way of getting information.

Part eight
Checklist

This section consists of a checklist for you to complete. Some of the questions have been examined in PART ONE to PART SIX; while other questions are there as an inducement for you to enquire further into the aspects of opening your own retail business.

Questions

Buy an existing business:	YES	NO
Have you analyzed the business?	☐	☐
Are you aware of the advantages?	☐	☐
Are you aware of the disadvantages?	☐	☐
Why is the business being sold? Do you know the **real** reason?	☐	☐
Have you examined the accounting records?	☐	☐
Have you had the accounting records checked by an accountant?	☐	☐
Have you checked the accounts payable?	☐	☐
Have you checked the accounts receivable?	☐	☐
Are you buying the inventory and, if so, is it at a fair price?	☐	☐
Is there a charge for the goodwill and, if so, is it a fair charge?	☐	☐
Is the price for the business fair?	☐	☐
Is the business what you really want?	☐	☐
Start a new business:		
Are you aware of the advantages?	☐	☐
Are you aware of the disadvantages?	☐	☐
What to sell and why:		
Do you have retail experience?	☐	☐
If not, have you learnt about it?	☐	☐
Have you decided what products to sell?	☐	☐
Do you know why you want to sell a particular product?	☐	☐
Can you get the products easily and continually?	☐	☐
Have you examined the product as to how well it can sell?	☐	☐
Your Market		
Have you researched the market?	☐	☐
Do you know what the total market is?	☐	☐
Have you chosen your geographic area?	☐	☐
Have you analyzed your geographic area?	☐	☐
Have you listed your competitors?	☐	☐
Do you know your competitors' share of the market?	☐	☐
Have you determined your share of the market?	☐	☐
Do you know why customers will buy from you?	☐	☐
Have you made a plan to attract customers?	☐	☐
Do you know how you will counter competition?	☐	☐

	YES	NO
Location:		
Have you analyzed your business location as to business potential?	☐	☐
Is there good customer accessibility to your location?	☐	☐
Is your location easily visible?	☐	☐
Will you have good exposure to customers?	☐	☐
Do you know the advantages of locating in a downtown business district?	☐	☐
Do you know the disadvantages of locating in a downtown business district?	☐	☐
If locating downtown, is there urban decay?	☐	☐
Do you know the advantages of locating in a major shopping centre?	☐	☐
Do you know the disadvantages of locating in a major shopping centre?	☐	☐
Do you know the advantages of a secondary shopping centre?	☐	☐
Do you know the disadvantages of a secondary shopping centre?	☐	☐
Do you know what type of business is usually found as a neighborhood store?	☐	☐
Is your business compatible to the surrounding area of your location?	☐	☐
Do you know your occupancy costs?	☐	☐
Is the store interior functionable for your business and products?	☐	☐
Will you have to make alterations?	☐	☐
Is the store exterior compatible with your image?	☐	☐
Finances:		
Have you forecasted your sales realistically?	☐	☐
Have you checked your competitors' prices?	☐	☐
Do you have the costs of what you are going to sell?	☐	☐
Have you estimated your operating expenses?	☐	☐
Have you done a cash flow?	☐	☐
Do you know what your start-up costs will be?	☐	☐
Have you allowed for unplanned expenses?	☐	☐
Are you going to set aside a reserve fund for initial operating costs?	☐	☐
Will your initial inventory purchases be on C.O.D.?	☐	☐
Have you examined the possibility of leasing equipment instead of buying?	☐	☐
Have you made an outline of your financial requirements?	☐	☐
Do you know the sources for capital?	☐	☐

	YES	NO
Business regulations:		
Have you checked with a lawyer as to applicable regulations?	☐	☐
Have you checked the municipal zoning by-laws?	☐	☐
Do you have a business permit?	☐	☐
If buying a business's inventory or an interest in a business, have you obtained an affidavit from the seller listing the names and addresses of the business's creditors and the amounts owed to them? (Bulk Sales Regulations)	☐	☐
Do you know the business, property, school and water tax rates for your business?	☐	☐
Does your building comply with government standards?	☐	☐
Are you aware of minimum wages and labour regulations?	☐	☐
Are you aware of the risk of false or misinterpreted advertising?	☐	☐
Do you know about product standards?	☐	☐
As you purchase goods for resale, have you a provincial sales tax exemption permit?	☐	☐
Have you obtained a certificate from your provincial government to collect provincial sales tax on their behalf?	☐	☐
Do you know that income taxes, deducted from employees' salaries, must be remitted each month to the federal and provincial governments?	☐	☐
Do you know the federal and provincial rates for your business?	☐	☐
Other Requirements:		
Do you know what insurance policies (fire, theft, accident, etc.) your business will need?	☐	☐
Do you know what your insurance policies will cost?	☐	☐

Conclusion

It is better to find out, before you are in business, the answers to those key questions: Can I manage a retail business? Can I afford to be in business? How much will the business cost me? Can I demonstrate that the business will have a good chance of being successful?

This booklet is a guide; an introduction to good management in planning the start of a retail business. What you do with the advice and how you apply it to the planning of your own retail business could be the difference between a successful concern and one that is in trouble.

Once you have carefully drawn up your plan, follow it through; yet be flexible to take advantage of opportunities and to avoid pitfalls.

We hope this booklet is of use to you. If you have any questions about anything that you have read, or feel that we have missed something that you need help on, please feel free to contact Management Services at any branch of the Federal Business Development Bank. We are there to help small businesses help themselves.

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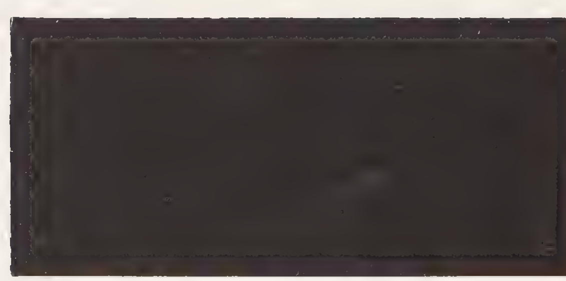
Pamphlet No. 16



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FINANCING FOR YOUR RETAIL BUSINESS

Pamphlet No. 16

FEDERAL BUSINESS DEVELOPMENT BANK
P.O. BOX 6021, MONTREAL, QUE. H3C 3C3

Good management is the key to success in your retail business and is the major assurance to a lender or investor that money put into your business is safe.

Financing for your retail business

PAGE

Foreword

"I need financing. What's involved?"

Knowing the "what's involved" can give a retailer a decided advantage in securing financing. When you are looking for financing, you must remember that you are in competition with other businesses for the same money. Lenders and investors look for evidence of good management from an applicant. Being prepared, knowing the procedures, and being aware of the various kinds of financing available to retailers are your first steps in demonstrating good management in your financing proposal.

This booklet is an introduction to retail financing. It looks at the problems of financing a retail operation, security in retail financing, and the kinds of financing available to retailers. As well, it examines the paperwork you will need when applying for financing from a lender or investor and the procedures involved in your application.

What is retail financing?

Retail financing can be simply defined as a combination of:

(1) the need for money by a retailer,
(2) the provision of money to a retailer by a lender or investor.

The need for money can be when your retail business is getting started, when you are doing well and wish to expand, and it can be in lean times to ensure survival. Retail financing therefore is a factor both when business is "booming" and when you are striving to hold off the "bust".

The provision of money can be divided into two categories: ownership money and borrowed money. Ownership money is equity financing and the use of a business's profits. Borrowed money is loans and trade credit. The borrowed money category is the most common form of retail financing. It is in this category that the words, "risk" and "interest", become important.

Before examining the kinds of financing available to retailers, we should see how lenders view a loan proposal. As borrowing money will be your usual recourse for financing, it is advisable to know why retailers can sometimes run into difficulties obtaining their financing.

Why do retailers have problems obtaining financing?

The major reason why a great number of retailers have their loan proposals reduced or, at worst, turned down is because of limited security.

Imagine, instead of being a retailer, you are a lender and are faced with the following situation:

Jim and Betty Nickle, who have been residents in your town for the past fifteen years, are planning to lease premises on Main Street. Their new store will be called 'Nickle Shoe Shop'.

"You see," says Jim, "I've spent ten years as a salesman for a shoe wholesaler. So I'm a natural to open a retail shoe store. Plus think of my contacts."

"Well," you say cautiously, "that certainly seems to be an advantage. Let's look at your application. You want to borrow $30,000?"

"That's right. It's to cover my start-up costs. I have to paint the place and put down a carpet. I need counters, display racks and shelving. They will all be custom made. I need a cash register, a neon sign with 'Nickle Shoe Shop' on it, and I want to enlarge that front window. Plus I must pay three months' rent in advance. $20,000 of my loan will be for inventory. My suppliers will give me credit once I've established myself."

"I see," you reply and turning to Betty Nickle ask, "What about yourself, Betty? Will you keep your present accounting job at the cannery?"

"No, I'm not. Jim and I are enthusiastic about our venture. Both of us are going to work full time in the store. We're not afraid of hard work and we feel that our hard work now will pay off in the future. I'll be looking after the cash register and doing the clerical work. I'll also help Jim with the customers. That way we don't have to pay a salary to an outsider."

"That's one way of looking at it," you answer and, referring to the loan application, "The amount of your investment in 'Nickle Shoe Shop' will be $8,000, right?"

"That's the amount," agrees Jim, "It'll cover our working capital needs and we'll use it to pay the monthly loan payments."

Why are you, the lender, hesitant about loaning $30,000 to Jim and Betty Nickle? Why is the loan proposal questionable?

Jim and Betty are enthusiastic. They say they are going to work hard. Jim knows the shoe business and he has supplier contacts. Both Jim and Betty are longtime residents in the town. Betty knows bookkeeping from her job at the cannery. The store will be located right on Main Street and the town does need a local shoe merchant. Jim and Betty are investing $8,000. So what is wrong?

There are a number of problems with Jim and Betty's loan application. The problems fall into three categories: security, lack of equity, and debt load.

The first problem is security. If 'Nickle Shoe Shop' fails, how much of your $30,000 will you get back? Like the vast majority of retailers, Jim and Betty's operations will be in leased premises. Leasehold improvements such as painting, alterations, and partitions are not retrievable by the lender. Lighting fixtures, counters, shelving, and sign are usually custom made and, if they can be removed, have limited resale value. Rent paid in advance is also unretrievable as most retail leases are commitments for one year. It must be remembered that the lessor has one of the first calls on a business's assets, both by virtue of the law and by virtue of the business being on his premises.

Inventory is also a problem of security. You, as a lender, have little control over the inventory. You may be the last to know if it is still on the premises. If a business fails because it couldn't sell its inventory, what better chance has the lender to sell it, even at cost?

In financing a retail business, lenders want to be sure they won't lose their money. Therefore, the security for a retail loan is appraised by three different methods.

The most optimistic method is **Going Concern Value** which is an estimate of the business based on its capitalized earnings. This assumes that a selling price, sufficient to cover the loan, will be obtained if the business is sold as an ongoing concern. Of course this gives no indication of the value of the assets if the business is not sold in this manner.

En Bloc Value is an estimate of the price at which the assets could be sold, without alteration or removal, if the business has ceased to operate. The estimated value is only meaningful if one could assume that a prospective buyer will value the business in relation to how much it would cost him to reproduce a similar operation.

The third method by which lenders appraise security is **Current Liquidation Value.** This is the estimate of what price the assets might be expected to realize on a forced sale or on the winding up of the business. This is based on the assets being sold individually. The majority of lenders realistically use Current Liquidation Value in appraising the security for a loan.

Assets usually are the security for a loan. 'Nickle Shoe Shop' will be like the majority of retail operations: limited assets available as security. This, therefore, is the major reason why many retailers generally have difficulty obtaining their financing.

What about the problems of lack of equity and debt load?

In the case of Jim and Betty Nickle, their $8,000 is a lot of money to them and represents their savings. While few lenders, if any, will state a ratio of equity to borrowings, there must be a sufficient investment in the business by the principals of the business to ensure their continuing commitment.

What happens if they get their $30,000 loan and find that in the first few months they can't cover their commitments, or, if initially successful, they run into a slump for a couple of months? Will their $8,000 be sufficient? If not and if $8,000 is all they have as an investment — it could mean failure. A second loan at this stage may be impossible to find.

Debt load is the second problem area. A $30,000 loan of this nature might have a term of three to four years. This means payments of approximately $1,000 a month. 'Nickle Shoe Shop' will have to meet these monthly loan payments as well as the regular commitments of operating expenses (rent, heat, light, advertising, insurance, telephone, etc.), continuing inventory purchases, and a salary for Jim and Betty to cover their living expenses. Will their sales be sufficient?

Debt load and equity are factors which lenders consider when evaluating a business as a viable concern. Security is what lenders use to protect their loan in case they have misjudged and the business fails.

These last two sections of the booklet may appear to be very discouraging. But when you are seeking retail financing it is to your advantage to look at your request from the viewpoint of a lender.

What security can a retailer provide?

In a previous section of this booklet, you have seen that the major stumbling block in retail financing is security. Yet retailers do get loans; so what security does a retailer have that can be used to assist in securing financing?

The average retailer will usually be able to determine security from amongst the following:

- fixed assets
- assets separate to the business
- income separate to the business
- inventory
- accounts receivable
- customers' orders
- the business as a "going concern"

Fixed assets, by definition, are tangible long-lived items and are your land, buildings, and equipment. If you own the building and land where your business is operating, you are then in a strong position by giving a realty mortgage as security. The strength of this security will, of course, vary by the amount of unpaid mortgage and the market value of the property. Most retailers, however, are in rented premises, especially those in shopping centres and downtown business districts. So therefore their fixed assets are only equipment such as a cash register, adding machines, or a delivery truck. These have limited value as security.

Assets separate to the business can be your house, other properties, bonds, stocks, or your life insurance policy if it has a cash or paid-up value. In applying for a loan, the security of a saleable personal asset can satisfy the security aspect of a new retail business. The disadvantage to this arrangement is the linking of your non-business assets to the risk factor of your retail business.

Income separate to the business is sometimes an assurance to lenders that a loan will be repaid or that there is recourse to protect the loan. In cases such as this, the loan to the business would be treated as a personal loan and the amount of the loan would be in relation to the income. Income separate to the business would be where one or more of the business's owners has kept an outside job or has investment income. Again you are linking your non-business life to that of your retail business.

It should be stressed that lenders would only accept a situation like this for a short period of time. Twelve months at the most for, by then, a retail business usually indicates if it is a viable enterprise or not. A business should be able to support itself as justification for a loan, not depend on income separate to the business.

Inventory which often is the purpose of retail financing is, to certain lenders, security. The dollar worth of the inventory, the type (is it made up of "large ticket" items such as autos and refrigerators) and the turnover rate (how fast will it sell), are what determines the value of the inventory as security. When the retailer takes possession of inventory, ownership comes with it. Again it must be pointed out that because lenders can have little control over the inventory and the fact that most retailers do not deal in "large ticket" items that justify flooring, inventory is not normally retail security.

Accounts receivable, in most retail establishments, have been replaced by customers' credit cards. Usually only the large retailers that are suppliers on a major scale to other businesses or institutions carry receivables. The amounts and past due status of the receivables determine their value for security. Accounts receivable when the scale warrants, are used by retailers in factoring.

Customers' orders, if contractual and of a substantial volume and value, can be used as security. An example of a retailer in this situation is one who purchases disposable paper products from a manufacturer and has sales contracts with a number of restaurants. The sales contracts would be the security for purchasing the inventory. Generally, lenders would view this as short term. Customers' orders should really be considered as a facet of the business as a going concern.

The business as a going concern is when a retail business has proved itself as a viable and successful enterprise over a period of time and is reasonably expected to continue being successful. The security for lenders is the proven good management, the past earnings, and the future potential. Going concern status is a basis for lenders extending a line of credit.

What kind of financing is available to a retailer?

Your two kinds of retail financing are: ownership dollars and borrowed dollars. Let us examine both kinds, beginning with the four categories in ownership dollars (three of equity financing and one of profits).

Ownership Dollars:

Sole ownership is your first category of equity financing. The source of your financing can be your personal savings, securities, other assets, real estate, as well as borrowings from your relations and friends.

This is one of your most important sources of retail financing. The more of your own money that you put into your business will mean the less you will have to borrow and the less loan interest you will have to pay. If and when you do go to a lender, a good investment of your own will give the lender confidence in your business commitment.

It must be stressed that in a sole ownership you own all the assets and are responsible for all liabilities. All decisions concerning the business are yours alone. Therefore, when borrowing money from relatives and friends, it is advisable to have a written agreement setting out terms and conditions for having borrowed the money as well as what management advice, if any, these people will give you in operating your business.

Partnership is the second category of equity financing. It may be that you cannot come up with sufficient financing from your own sources as listed under sole ownership. You may not wish to or cannot go to a lender. Equity financing, in the form of one or more partners, can be a source for your retail business.

Your partner or partners will put up money and agree to share with you the ownership of the business and the resulting profits and losses. You will have to determine with your partners what their share of the business will be based on considerations both of amounts of money invested and their share in the management decisions. They may be silent partners, providers of money while you provide the know-how, or they could be working partners supplying both money and skills to the business. Partners are referred to as either general or limited. A general partner is active in management and is responsible for all debts and obligations of the partnership. A limited partner only contributes money and is not responsible for the business's debts and obligations.

Limited company is the third category of equity financing. This means that you incorporate your retail business and sell shares of the company to a number of specified people. Your business is a legal entity, separate from yourself and the other persons (all of you are shareholders) who own it. Your business can own assets, make contracts and conduct business transactions in its own capacity.

The majority of incorporated small retail businesses are private companies. As a private company, there can be legal restrictions as to the number of shareholders and the transfer of shares. The amount of the shares and the value and rights are determined at the time of sale. The percentage of the shares (who has how many) dictates controlling interest of the business. If an incorporated business fails, each shareholder (owner) is liable for all shares he or she has purchased but not paid for. The shareholder is also responsible for any loans personally guaranteed for the business.

There are two good reasons to consider outside investors in your retail business:

These outside equity monies do not normally have to be repaid (on a regular basis) and are therefore not a drain on your business's cash flow.

Your outside investors have a vested interest in your business and you can look to them for continuing support.

It is better to own a large percentage of a profitable business than one hundred percent of a business that fails.

Profits is the last category in ownership dollars and is the most ideal source of retail financing for an existing business. This is where you retain a portion of the profits from the business for reinvestment. This supplements or replaces going to a lender or to outside investors when you need financing.

Borrowed Dollars:

Borrowed dollars, sometimes called debt financing, will be your most common kind of retail financing. Borrowed dollars are usually identified by their terms of repayment time: short-term, intermediate-term, and long-term.

Short-term financing is generally considered to be financing extended to a business for one year or less. Retail businesses usually seek short-term loans for working capital purposes such as operating expenses, seasonal slack periods, and inventory build-up for sales. Short-term loans may also be used for an interim period while arranging longer term financing.

Short-term financing is easier to obtain than intermediate-term and long-term. Usually it is less expensive than the longer term financing. The security for short-term financing is normally the business valued as a going concern, though other security may be requested. Short-term financing is generally on a revolving basis, renewed regularly, though it can often be withdrawn on short notice. Short-term financing is expected to be paid from the business's ordinary operating income once the temporary need is over.

Intermediate-term financing is used by retailers for periods of approximately one year to five years. Intermediate-term financing provides monies for other than temporary needs. The purposes can be: purchasing of an existing business, establishment of a new one, additional working capital for expanded business operations, purchase of assets, or for leasehold improvements.

When arranging for this term of financing, it is important to specify the duration of the loan as well as to establish in detail its terms and conditions. Be aware of such facets as interest rate, front end charges, security requirements, term and payment flexibility and also the possible requirement for periodic financial statements. Because of the years involved and the commitment you are tying your business down to, you must be sure that the terms and conditions are compatible with the short and long-range plans of your business. These loans usually require security.

Long-term financing is financing for a period exceeding five years. This category of borrowed dollars can be the most difficult for a retailer to obtain, unless the purpose of the loan is for a high value asset such as a building or land. Long-term financing, which requires the same attention as intermediate-term, usually is met by equity financing or equity financing combined with intermediate-term financing. Often a retail business's long-term financial needs should be met by more equity investment rather than by a loan.

Some types of short and intermediate-term financing

Short and intermediate-term financing are also referred to by other names than just by length of time. Briefly described are a number of common types of short and intermediate-term financing that can be available to retailers. In reading this section, you should not assume that all of these types of financing are available to your retail business.

Trade credit is the most often used form of short-term financing by retailers. This means a supplier will not insist on immediate payment by a retailer for purchase of merchandise. Terms can be arranged between both parties as to when payment will be made: 30 days, 60 days or longer. This allows the retailer to obtain inventory without an immediate cash outlay and to begin selling it right away.

Most suppliers have terms of net 30 days and will charge a retailer interest after the due date for any accounts past due. Not having to immediately pay for inventory allows a retailer to use his or her working capital for other aspects of the operation. It also gives the retailer time to generate sales to pay for the inventory. This arrangement between retailer and supplier usually only occurs with an established business.

Line of credit is an agreement between a business and its bank. The bank agrees to grant loans as requested as long as they do not exceed a determined and agreed upon maximum. The retailer will sign notes of specific amounts and present them to the bank to cover loan needs. The notes are returned by the bank as the retailer repays. These loans are at times unsecured and are based on the business as a proven viable operation. Retailers who have seasonal needs for funds because of their product will use a line of credit with their bank.

Temporary financing, unlike a line of credit, is a short-term loan for a specific period of time ranging from 30 to 90 days. Its purpose is generally for seasonal financing or for a build-up in inventory. While this type of loan is often unsecured and based on the business as a proven viable enterprise, security can at times be requested. The loan may also be on demand, meaning it can be called at any time for payment.

Factoring is an expression used where a retailer sells his or her accounts receivable to a factoring company. The retailer gets immediate cash for these receivables. The factor who now has the responsibility and risk of collecting the receivables, will levy a percentage service charge on the face amount of the receivables. The retailer is also charged interest for the period between the time of obtaining the money and the maturity date of the receivables.

The amount of the receivables, the age of the receivables and, above all, the credit rating of the retailer's accounts receivable customers, will dictate what receivables a factor will buy. Factoring, while giving immediate cash, is a more expensive way of raising money when compared to other forms of retail financing.

Assignment of accounts receivable differs from factoring in that the retailer retains control of the receivables. The receivables are assigned to a bank or other lender as security for a short-term loan. The lender will loan a certain percentage of the face value of the receivables and charge the retailer interest and possibly a service fee. When requiring funds, the retailer prepares a schedule of assigned receivables and signs a note to the lender. When the receivables are collected the retailer pays the lender and retrieves the note. The soundness of the receivables, as in factoring, dictates their value for this type of retail financing. Assignment of accounts receivable is often the rotating security taken for a line of credit when security is requested.

Flooring is used by retailers selling "large ticket" items such as automobiles and appliances that can be easily identified and have a high unit value. In this situation, the lender pays the manufacturer the cost price of the inventory and retains the ownership. The retailer has possession and sells the units. As each unit is sold, the retailer pays the lender the amount due on the unit. The retailer signs a note in this type of financing and pays an interest charge for the time taken to sell the unit and pay the lender.

Chattel mortgage loan, for a retailer, would be a short or intermediate-term loan which is secured by the movable assets (chattels) of the business and sometimes, if necessary, the movable assets belonging personally to the owners of the business. The security is discharged (released) to the retailer upon the payment of the loan. The current liquidation value of the chattels can qualify the amount of the loan.

Note: In the province of Quebec, "Commercial Pledge" is the equivalent security used for chattel mortgage. Commercial pledge loans can only be granted to the business contracting the loan on assets owned by it.

Floating charge debenture loan, again in a short or intermediate-term situation, is a loan secured by a general claim on the total equity of the business. Unlike a chattel mortgage and a commercial pledge which specify and describe a particular asset as security, a floating charge debenture does not describe any specific assets. Instead, all the assets are described in general terms and could be disposed of in the ordinary course of business until default occurs.

The lender may include certain restrictions and controls on the business so as to ensure that the equity of the business does not fall below that deemed necessary to secure the loan. In certain provinces, companies must be incorporated to obtain this form of financing. A business with a floating charge debenture as security may still obtain other short-term credit by charging (e.g., chattel mortgage) specifically the assets of the business. The holder of the floating charge debenture ranks after the claims of lenders holding specific securities such as chattel mortgages.

Note: In the province of Quebec, "Trust Deed" is the equivalent security used for floating charge debenture.

Installment purchase plan can be used by retailers to purchase chattels (e.g., equipment, vehicles, furniture). They obtain possession and title but, instead of paying for the purchase immediately, agree to pay in installments over a specified period of time. Each installment will usually have built into it repayment of principal, plus interest and service charge. In the majority of cases, conditional sales contracts are used instead of installment purchase plans.

Conditional sales contract differs from the installment purchase plan in so far as the retailer has possession of the purchased chattel but not the title. Payments are made by the retailer over a specified period of time. Each payment includes repayment of principal, plus interest and service charge. Upon the last payment, the retailer becomes the owner of the purchased chattel.

Equipment leasing is the use of equipment or other movables for an agreed period of time and rental. Certain leasing arrangements enable the lessee to apply the payments against the purchase price, or pay a residual value at the end of the lease period and take title of the equipment.

What is the difference between term loan and demand loan?

It is important for a prospective retail borrower to be aware of the difference between the words "term" and "demand". As shown earlier, you should not judge loans solely on interest rates but must examine all their aspects. Knowing the advantages and disadvantages of both types can help you choose the best one for your business.

Demand loan	Term loan
• interest rate at time of signing usually lower than term	• interest rate at time of signing slightly higher than demand
• fluctuating interest rate — rates go up, you pay more	• normally fixed interest rate — your payments stay the same
• often unsecured — based on proven business record	• usually secured by fixed assets
• loan can be called any time by the lender and payment demanded	• time length of loan specified and agreed upon
• quicker to obtain	• takes time to obtain

What determines interest rate and risk?

It is in the category of borrowed dollars that the words "risk" and "interest" rate become important. **Interest** is what you pay a lender for having used the money. **Risk** is the degree of danger the lender has in losing the money loaned to you. Normally, the higher the risk, the higher the interest rate you will be charged.

What determines risk is the amount of shortcoming in any of the following:

- management ability of the principals
- equity invested by the principals
- debt load — will the earnings be sufficient to meet all required obligations?
- security

If your loan proposal is a safe one, you will have relatively little trouble in obtaining the financing. If your proposal is judged to be risky, your interest rate might be higher and you could have difficulty finding a lender. The term of the loan may also have to be shorter.

Can a retailer generate funds from within the business?

While there is no guarantee that you can generate your financing from within your retail business, unless you had established a fund from prior years' profits, you should do a close examination of your business.

All areas affecting working capital such as accounts receivable, accounts payable, and inventory should be questioned to see if any changes could make additional funds available. The changes could be basic resulting from questions such as: Do my receivables need tightening up and are there past due accounts I can collect? Am I paying my accounts payable too soon and, if so, can I negotiate longer terms with my suppliers? Do I have slow moving items in my inventory that could be discounted for a special sale?

Preparing a cost analysis can help you verify that there are no unprofitable activities or products in your business. Make sure all your fixed and movable assets are contributing to the profits of your business. An example of a noncontributing asset would be owning a delivery truck that spends more time parked behind your store than it does making deliveries.

This type of examination, which should be done periodically, can help you in determining your financial requirements by showing up any weaknesses in your business. This is in addition to possibly being able to generate funds from within to supplement or replace outside borrowings.

How does a retailer establish a credit rating?

It is very important to have a good credit rating. Both suppliers and lenders, when considering the financing of your retail business, will refer to your credit rating. Your credit rating is a major factor in determining the amount of the loan or the extension of credit to you.

If you are a new retailer, how do you establish a credit rating? The easiest and quickest way is to get in touch with the local office of a reputable credit reporting agency. In Canada, a retailer has a choice of both national and international credit reporting agencies as well as several specialized agencies that serve certain types of business or particular areas of the country.

A credit reporter will contact you to obtain financial statements of your business and possibly yourself if your business is in its first months of operation. You may be asked to supply information such as the history, operation, payment record, finances and banking of your business. Personal and business references can also be requested. The credit reporter might obtain additional information from your chartered bank (what your banking history is), your suppliers (your payment history — slow or prompt), and the public record (judgements, non-responsibility notices, registered chattel mortgages, and bankruptcies).

All this information is compiled into a brief synopsis of the business, its estimated financial strength, and a credit appraisal based on the assessment of such factors as management, survival and growth ability, and payment records. This report, referred to as your credit rating, is available for your inspection if you so wish. Most businesses recognize that it is better to supply credit reporting agencies with full and accurate information resulting in a correct rating than run the risk of their file not being complete or current.

To maintain a good credit rating, you should make all payments on time. If you can't, let your creditors know immediately and tell them why. Arrange a partial payment if possible, but keep your creditors informed of delays. This will continue to show responsible management and can help to protect your credit rating.

What paperwork does a retailer need when seeking financing? And why?

Many retailers, when going to a lender or an outside equity investor, are sometimes perplexed by the demands for information and paperwork put to them. Is all this information and paperwork really justified? What is it needed for?

While you know what your retail business is all about, the person whom you have approached for financing will not know it in the same detail. Naturally, he or she will want to learn as much as possible about the business to be financed.

It is very easy to view a lender or investor as an adversary. Is this not someone whom you must do battle with to get your financing? Aren't the information requests craftily designed to embarrass you and to justify the decision not to give you a loan? And wasn't that decision made upon first hearing about you?

Of course the answers are no. A lender or investor is in business to supply money. And you, the retailer, want to explain **why your** business should be financed. Because you are the one who best knows your business, and because you must prove that a loan or investment in your business will not result in a loss, it is to your advantage to give as much information as possible.

Good management is the key to success in your retail business and is the major assurance to a lender or investor that money put into your business is safe. Good management must show in your financing proposal.

Let's examine what information and paperwork is required and why a lender or investor wants it. Not every lender or investor will ask for all this paperwork and some requirements may not be applicable to your retail business. But it is best to be prepared.

The Established Retail Business

Paperwork	Why
1. Resumé of the business: • when started • who started • why started • where located • legal structure • operating details • product details • major suppliers & customers • advantages business has	• Describes the basic non-financial background of the business. Shows the lender or investor what the business is all about.
2. Resumé of the principals and key people working in the business: • education • experience • why valuable to the business	• Describes who is who. A business is people and people make the management. This allows the lender or investor to assess management abilities.
3. Financial statements for the last 5 years; if less than 5 years, as many years as possible: • profit and loss • balance sheet • statement of retained earnings	• Provides the financial background of the business. Allows the lender or investor to analyze the assets, liabilities, historical growth, the initial equity and the shortfalls. Shows what the business is worth. Gives a financial assessment of the management abilities.
4. Prepare a profit and loss statement for the current year and for at least the next 12 months (your forecast). Will be important to justify calculations, especially sales.	• Will show the future of the business: survival, growth, ability to repay loan, return on investment. Indicates anticipated sales and profits. Shows the direction of the business.
5. Cash flow for at least 12 months. Inventory needs must be justified as well as revenues. Include the loan proceeds.	• Shows why the loan is needed. Shows cash highs and lows. Will indicate to lender where problems can occur in repayment. Shows inventory levels and when cash required. Will show if loan amount justified — needs may be greater than loan and more financing may be required.
6. Personal financial statements	• Will show lender or investor if there is any additional financial support in case the business gets in trouble — what the business has to fall back on.
7. List of security available for the business: • description • when bought • price when bought	• Required if loan has to be secured by fixed or movable assets, especially if chattel mortgage necessary.

Paperwork	Why
8. Copy of lease	• Will substantiate rent payments, restrictions, and penalty in case of default. (Restrictions can be limits as to number of sales a year, what fixtures can be installed.)
9. Insurance policies on the business	• Lender and investor want to know if business insured against losses and liabilities and who is the beneficiary.
10. If you own the building: • copy of mortgage • building specifications • amount of paid up mortgage • any liens • recent appraisals if any	• Will show lender and investor the situation re this major security item. Appraisal may show building worth more than book value.

The New Business Being Started Up

Paperwork	Why
1. Resumé of the principals and key people (if known) who will work in business: • education • experience • why valuable to the business	• Describes who is who. A business is people and people make the management. Allows the lender or investor to assess management abilities.
2. Personal financial statements	• Will show lender and investor the financial background of principals; valuable especially if never in business before. Will show if there is any additional financial support in case the business gets in trouble — what the business has to fall back on.
3. Financial statements for your proposed first year of operations: • profit and loss • balance sheet Will be important to justify calculations, especially your forecast of sales.	• Will illustrate the anticipated operations of the business. Will indicate anticipated sales and profits. Shows why the loan is needed. Allows the lender or investor to analyze.
4. Cash flow for at least 12 months. Inventory needs must be justified as well as revenues. Include the loan proceeds.	• Shows cash highs and lows. Will indicate to lender where problems can occur in repayment. Shows inventory levels and when cash required. Will show if loan amount justified — needs may be greater than loan and more financing may be required.
5. List of security available for the business: • description • when bought • price when bought	• Required if loan has to be secured by fixed or movable assets, especially if chattel mortgage necessary.
6. Copy of lease	• Will substantiate rent payments, restrictions, and penalty in case of default. (Restrictions can be limits as to number of sales a year, what fixtures can be installed.)
7. If you own the building: • copy of mortgage • building specifications • amount of paid up mortgage • any liens • recent appraisals if any	• Will show lender and investor the situation re this major security item. Appraisal may show building worth more than book value.

A new retail business will have its forecast and cash flow closely scrutinized by a lender or investor. There are no past records to prove that the business is a viable venture. You must be sure your estimates of sales, expenses, and profit are realistic and can be justified. Most importantly, your levels of inventory will have to be carefully forecasted. You, as a new retailer, may be asked to substantiate any terms of credit or arrangements that you have made between your business and your suppliers. Having to pay C.O.D. for your inventory when you were expecting terms of net 30 to 60 can play havoc with your financial planning.

Both a new and established retailer could be asked to produce a business plan stating goals and objectives covering the next three to five years of operations. For this future period of time, you may be asked to identify your short and long-term money needs as well as your plans for financing these needs. You may also be questioned on your personal insurance arrangements and what happens to the business in the event of your death.

To get financing, the burden of assuring that a loan or investment in your business will not be lost is with you. Your only method to demonstrate this assurance is by the use of paperwork and information.

It is advisable at this point in our booklet to stress the importance of your paperwork, especially your financial statements, your forecast and your cash flow. Accuracy is crucial. You may wish to consider at this stage qualified help in the preparation of your financing proposal. Even with this qualified help, make sure you understand your proposal. Your financial statements, your forecast and cash flow prove not only to the lender or investor that your business is viable but also to yourself. Don't forget you have an investment in the business too.

What is the procedure in applying for retail financing?

Your first step is to determine the amount of financing your retail business needs. In determining the amount, you will have to prepare a forecast, a cash flow, a profit and loss statement and if a new business, a set of financial statements for your proposed first year of operation.

Your second step, in conjunction with the above, will be to analyze your business and determine whether you can find all or a portion of the required funds from within your retail business.

Your third step can be an initial contact with a lender or investor to find out what paperwork you will be required to present with your application. Or, you can go ahead and prepare as much paperwork as you think will be necessary.

The completeness of your initial approach, in the sense of having as much documentation as possible, will show management ability on your part, as well as speed up the process of your application. It can make more sense, instead of asking what paperwork is required and then at a later date bringing it in, to show up with more paperwork than is necessary and start talking financing right away.

It is important to schedule the interview and to allow yourself time to get the financing. Nothing gives a poorer impression than a "I need it tomorrow" financing request.

Your fourth step is one of communication. Explain your business and **why** you should be given financing. Be free with your information and, at the same time, find out all you need about the financing: terms, payment, interest rates, security requirements, front end charges and related fees. Don't commit yourself without a complete understanding of what is involved.

Your fifth step may be getting additional information or substantiating, for the lender or investor, statements that you have made. This could include such things as verifying your sales figure, confirming term credit with your suppliers, or detailing your year's inventory requirements.

What happens if you are turned down? Find out why. Use the lender's or investor's experience to your advantage. Find out what is wrong or weak in your proposal. Correct it and see if you can reapply. Have you chosen the right type of financing and the right type of lender or investor for your retail needs?

Maybe the answer is yes to your application but includes an "if". At this point you must decide if you can accept the lender's or investor's conditions for the loan. Are the conditions severe restrictions or standards that place too drastic a curtailment on your operations? Are you committing yourself to more than you intended? Or, are these conditions normal financing requirements? You must be sure of the effect the conditions will have on your business.

Once you get the loan or investment keep in touch with the people who have financed your retail business. Send regular statements and progress reports. You never know when you may need additional financing and, by having kept your lender or investor in the picture, you will speed up your next application.

Conclusion

Good management is the key to success in your retail business and is the major assurance to a lender or investor that money put into your business is safe. Good management must show in your financing proposal.

We hope this booklet has helped you understand some aspects of retail financing. If you have any questions about anything that you have read, or feel that we have missed something that you need help on, please feel free to contact Management Services at any branch of the Federal Business Development Bank. We are there to help small businesses help themselves.

CASE

Counselling Assistance to Small Enterprises

The Federal Business Development Bank's Management Counselling Services known as CASE (Counselling Assistance to Small Enterprises) assists small businesses in Canada to improve their methods of doing business.

Virtually any established business or anyone about to engage in a business enterprise can apply provided it has had prior discussion of its needs with its appropriate business advisor(s), and provided it has no more than seventy-five employees.

This service is provided at a moderate fee and supplements counselling services obtainable from the private sector. The counselling is performed by retired business persons selected for their management experience.

To obtain more details on CASE, contact any of the CASE offices listed below or any FBDB branch office.

CASE Offices

City	Street	Telephone
Atlantic Region		
ST. JOHN'S	4th Floor-Beothuck Building	(709) 737-5515
CORNER BROOK	Third Floor, 4A Herald Ave.	(709) 639-9126
HALIFAX	Suite 914, Cogswell Tower	(902) 426-2474
MONCTON	860, Main St., Suite 702	(506) 858-2973
FREDERICTON	440 King Street, Suite 646	(506) 452-3022
CHARLOTTETOWN	139 Kent Street	(902) 892-3576
Quebec Region		
MONTREAL	800 Victoria Square	(514) 283-4384
QUEBEC CITY	925 Chemin St. Louis	(418) 694-3003
SHERBROOKE	2532 King St., West	(819) 565-4757
LAVAL	2525 Marois Blvd.	(514) 681-9291
CHICOUTIMI	475 rue de Champs Elysées	(418) 545-1501
LONGUEUIL	1000 de Serigny Street	(514) 670-0633
ST. LAURENT	750 Laurentian Blvd.	(514) 748-7470
Ontario Region		
TORONTO	5th Floor 204 Richmond St., West	(416) 593-1143
HAMILTON	8 Main Street	(416) 523-2954
SAULT STE. MARIE	421 Bay Street	(705) 949-1997
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Pamphlet No. 17

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RETAIL PRICING

Pamphlet No. 17

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There is far more to a successful retail pricing strategy than just applying a price tag. Behind the price tag is good management.

Retail pricing

Foreword

Why is retail pricing so important?

What the customer will buy and in what quantity are often determined solely on a retailer's prices. This in turn directly affects the retailer's revenue and, ultimately, profit.

Effective retail pricing, therefore, should be considered as a vital component of good management.To many retailers, pricing is an art learnt by experience and constant practice. But whether you are a new retailer or an established retailer, you should be constantly monitoring your pricing strategy.

This booklet introduces you to some aspects of retail pricing. It looks at the concept of retail pricing, what your retail price must cover, the product mix, pricing by competition and market, psychological pricing, and the use of loss leaders and markdowns. As well, it includes a simple price coding system and a pricing checklist to help you monitor your pricing strategy.

Retail pricing defined

Retail pricing can be simply defined as applying a selling value to merchandise for sale.

Like most definitions, this one fails to give the complete story. As a retailer, pricing will be a major sector of your business in which you will be constantly concerned. The prices that you set must be competitive with other retailers' prices or your customers will shop elsewhere. Yet, at the same time, your prices must be set high enough so that the difference (markup) between your costs and sales will cover all your operating and selling expenses and, most importantly, give you a reasonable profit.

Your pricing strategy must be flexible so that it takes advantage of opportunities such as customer demand, or recoups mistakes such as overstocked or slow moving inventory. A retailer's pricing strategy must also include the use of prices to promote the business, be it special sales, deep discounts or loss leaders. Pricing must reflect a retailer's product mix insofar as knowing which products can take a high markup and which products a low markup without adversely affecting the business's total gross profit.

Markup on cost and Margin on selling

To examine retail pricing, we should first look at two common terms used by retailers: **markup on cost** and **margin on selling**. It is important to understand these terms, especially, when expressed as percentages.

Markup on cost is the difference between cost of merchandise and retail price. The cost of the merchandise is usually the base invoice price plus any delivery charges and minus any payment discounts (e.g. 2% 10 days) or quantity discounts. The retail price is what the customer pays for the merchandise.

To calculate markup on cost as both a dollar figure and as a percentage, retailers use the following simple formulas:

Retail price – Cost of merchandise = Dollar markup
Dollar markup ÷ Cost of merchandise = Percentage markup

If you are selling a product at $12.50 and you subtract your cost of $10.00, your markup on cost as a dollar figure is $2.50. To find the percentage, divide the dollar markup on cost by the cost ($2.50 ÷ $10.00) and the answer is a 25% markup on cost.

Margin on selling is a percentage calculation that allows you to find out what percentage your dollar markup on cost is of your retail price.

Retailers use this formula to calculate the percentage of margin on selling:

Dollar markup ÷ Retail price = Margin on selling

In our previous example, the product that sold for $12.50 had a dollar markup on cost of $2.50. Dividing the dollar markup figure by the retail price gives us a 20% margin on selling ($2.50 ÷ $12.50 = 20%).

When making comparisons of their businesses to statistics or when deciding their price strategies, retailers are careful not to confuse the terms and percentages of markup on cost and margin on selling. The following table shows the percentage equivalents between markup on cost and margin on selling:

Markup on cost percentage (%)		Margin on selling percentage (%)
10.0		9.0
15.0		13.0
20.0		16.7
25.0		20.0
30.0		23.1
33.3		25.0
35.0		26.0
40.0		28.5
45.0		31.0
50.0		33.3
60.0		37.5
66.7		40.0
75.0		42.8
100.0		50.0
apply the above markups on your cost price	**and**	**you will obtain these margins on your selling price**

Finding the established markups

Pricing strategy, with its adjustments of retail prices, should not begin until the retailer has found out what the established markups are on the merchandise to be sold. This is especially a problem for the new retailer who must base his forecasts of gross trading profit on the most accurate estimates possible.

Many retailers determine established markups on merchandise by using the following sources:

- wholesalers (travellers)
- manufacturer's suggested list price
- other retailers
- auditors, accounting firms
- personal observation

Wholesalers (travellers) will be your primary source of information on what markups are possible on merchandise the traveller is wholesaling. The traveller will have partially based the suggested markup on what his or her other retailer customers are applying. As well, the traveller is in competition with other wholesalers and will know the wholesale market which includes the suggested markups for retailers. The traveller's suggested markups are usually fairly dependable. The traveller will not wish to lose you as a customer which would happen if you found the suggested markups to be noncompetitive.

Manufacturer's suggested list price is a selling price established by the manufacturer. The purpose is to provide the manufacturer with a uniform pricing presentation at the retail level thereby keeping the product in a certain price quality bracket. Sometimes the suggested list price is printed on the package containing the product. The markup allowed to the retailer by the suggested list price is usually sufficient to cover, on a per item basis, the retailer's operating and selling expenses. As well, there is enough leeway in the markup to allow price adjustment.

Other retailers can be a source for established markups. This includes both retailers in locations that are noncompetitive to you as well as your direct competition. A noncompetitive retailer may be quite willing to give you markup information as well as other advice. The retailer, with whom you will be in direct competition, will be far less inclined to discuss markups. In this case, you will have to find out the wholesale costs of products and match them to the competitor's retail prices. It is important to condition your comparison with other retailers by factors such as location, size, and market.

Auditors, accounting firms can be another source of information for established markups. This can be especially true if you are, or will, use an auditing or accounting firm that deals with other retailers. Of course, a certain amount of confidentiality with accountants and their clients must be respected.

Personal observation is another source of markup information. This may entail reading trade journals, catalogues and other written materials. It might include visits to suppliers and manufacturers. Retail associations are also a personal contact source not to be overlooked. Friends or acquaintances may work in or own a retail establishment similar to one you have planned or have established. They may be willing to talk about their pricing structures. If in the early planning stages of a retail operation of your own, have you considered working in a similar retail concern for six months or so to gain information and experience?

A final comment should be made on established markups. There is no mystery to established markups. Today's markups result from trial and error over many years and represent a fine sifting of the many factors in each line of goods. There are traditional markup patterns expressed as averages for the many types of retail businesses. Once you know the established markup the next question is one of determining whether or not you can afford to be in business at the established markup.

Can you afford the established markup?

Imagine that your research into established markups has shown that a 25% average markup can be applied to the type of merchandise you plan to sell. Does that mean you immediately go ahead and use that markup? Your answer should be no. Before applying a markup, most retailers will first determine if their sales will be sufficient with that markup to give enough gross trading profit to (a) cover all selling and operating expenses and (b) to provide a reasonable net profit.

The following steps are suggested in determining what markup on cost a business can afford:

- add up the yearly operating and selling expenses
- estimate sales
- calculate cost of goods sold
- obtain the gross trading profit
- obtain the operating profit
- see if the venture is viable

The new business, unlike the existing business, will not have the benefit of previous years' profit and loss statements. Therefore, the estimates of sales, expenses, and profit must be realistic.

To determine whether or not your retail business can afford the established 25% markup on cost (20% margin on selling), you have prepared the following forecast:

Forecasting to check the markup

	$	$	Percentage of sales
Sales	200,000		100%
Cost of goods sold	160,000		80%
Gross trading profit	40,000	40,000	20%*
Expenses:			
Wages (part-time staff)	2,300		
Rent	6,000		
Light, heat & power	1,000		
Insurance	800		
Advertising & promotion	2,300		
Office & accounting	400		
Building maintenance	300		
Telephone	300		
Delivery	1,200		
Loan interest & bank charges	200		
Depreciation	200		
Total expenses	15,000	15,000	
Operating profit		25,000	12%
Owner's withdrawals		15,000	
To surplus		10,000	5%

* It is important, when comparing your retail business to previous periods of time, to refer to this percentage. A reduction here, even if sales have increased, will generally mean your operating profit is going down.

Let us analyze your forecast and see how you prepared it and what conclusions you are able to make.

Add up the yearly operating and selling expenses was your first step in preparing the forecast. This part of the forecast lists both fixed costs such as your rent, insurance and variable costs such as wages and telephone. In forecasting expenses without the benefit of prior years' financial statements, it is important to be accurate. Errors, if any, should be in overestimating the expenses.

Estimate sales was the most difficult part of doing your forecast. You had to honestly determine what your share of the market would be. You had to know the kind of customer and quality demand you would have in relation to your merchandise. If your product is a high priced item, you determined your sales figure by multiplying the number of items you estimate to sell by the selling price. If you are going to carry a large number of products with a low price, your sales figure was determined on a volume basis. In all cases, you may have determined your sales based on a percentage estimate of your share of the market.

Calculate cost of goods sold was done by adding the wholesale cost of your merchandise along with any delivery charges in bringing the merchandise to your shop. The figure for cost of goods sold is, of course, in direct relation to your anticipated sales.

Obtain the gross trading profit and **obtain the operating profit** are simple calculations. Your forecasted operating profit is $25,000 or 12% of total sales. As the owner, you plan to withdraw $15,000 for your personal expenses and leave $10,000 to surplus which is 5% of total sales.

Your conclusion, after analyzing the forecast, is that your business is viable at the established overall markup of 25%. This, of course, depends on actually selling what you have estimated you will sell and on not exceeding your estimated expenses.

Had your business not been a viable operation at the established markup, increasing the markup would not necessarily have been the answer to make the business viable. Cutting back expenses, reducing drawings and trying to increase the volume of sales are the areas you would consider before increasing markups. (See section "Before you increase the retail price").

With a viable operation, you will probably ask yourself a number of questions such as: Am I making a reasonable profit? Could I improve it by selling more? Could I reduce my expenses? If I reduce my markup, will I sell more? If I increase my markup, will I sell less but obtain a larger gross trading profit?

These last two questions are part of a retailer's pricing strategy and lead us into the next section of this booklet which looks at the product mix.

The product mix

In the example forecast, we saw that an overall 25% markup on cost (20% margin on selling), with a realistic forecast of sales, means that the business is viable.

Not all the merchandise will have a 25% markup. Some products will have a smaller markup and others a higher markup. As a retailer, you must know this mix of markups which is part of your pricing strategy. You must also know the relationship (how one offsets the other) of these various markups by sales volume. The sales volume of low markups and high markups must, in total, obtain the overall 25% markup on cost (20% margin on selling) that you need to keep your business viable.

To know the product mix, some retailers do the following type of forecasting exercise:

Product Classification	Cost Price	Retail Price	No. of Units to be sold	Annual Total Sales	Gross Trading Profit
	$	$		$	$
Blouse A1	12.50	15.00	300	4,500	750
" A2	14.80	18.50	300	5,550	1,110
" A3	9.79	14.00	300	4,200	1,263
" A4	16.35	19.00	300	5,700	795
Skirt B1	14.25	16.50	200	3,300	450
" B2	17.69	23.00	200	4,600	1,062
" B3	18.10	22.60	200	4,520	900
" B4	12.15	14.60	200	2,920	
Jacket MM2	16.50	20.65	100	2,065	415
" MM3	18.35	22.95	100	2,295	460
Sweater SR1	12.49	16.25	300	4,875	1,128
" SR2	11.00	14.30	300	4,290	990
" SR4	9.85	12.80	300	3,840	885
Slacks TT1	8.40	10.50	200	2,100	420
" TT2	10.25	12.80	200	2,560	510
Scarves W1	2.00	2.50	100	250	50
				200,000*	40,000*

* Refer to the forecast on page 5

In checking the above calculations, you will see that the markup on cost varies. Some retail prices include the average 25% markup on cost, while others have markups ranging from less than 20% to over 40%.

The purpose of this type of exercise is to show the retailer which products, in what quantity and at what markup, have to be sold to generate what gross trading profit. This is shown on an individual product basis and in relation to the total required gross trading profit.

A successful retailer knows his or her product mix. When adjusting markups, the product mix must be kept in mind when trying to either reach or exceed the required gross trading profit.

Factors affecting retail prices

The product mix, with its various markups, provides enough difficulties in obtaining the required overall markup. Yet, there are many factors related to the product mix and market conditions which the retailer must constantly keep up with in setting prices. Let us look at some factors that can affect your retail pricing.

Reduction in wholesale price can come about in a number of ways. The wholesale price may be reduced by the purchase of a larger quantity (quantity discount). The wholesaler may also reduce the price because the line is being phased out, or the product is slow moving and either the wholesaler or the manufacturer is overstocked. It may also be a case of the wholesaler wishing to promote a new product, thereby offering a price reduction to encourage the retailer to stock and display the product.

When faced with a reduction in the wholesale price, the retailer must decide whether to carry the new stock at the old retail price, thereby obtaining a larger gross trading profit, or to reduce the selling price. Reduction of the selling price need not be in direct proportion to the reduction in the wholesale price. The retailer should adjust the markup to the best advantage of the business. This could mean a quick discount sale or maybe a lower selling price spread over both old and new stock.

It must be stressed that you should look closely at the reason why the wholesale price is being reduced. A bargain from the wholesaler ceases to be a bargain when it sits on your shelves too long in the unsold status. Slow moving or dead stock and the space it occupies cost you money.

Increase in wholesale price usually is less of a problem for your retail pricing than a reduction in the wholesale price. In most cases, your markup percentage will remain the same. Some retailers occasionally will water down the wholesale price increase by averaging it over existing stock purchased at the previous price. This is a method used in undercutting the competition.

Slow inventory turnover, as a factor affecting your retail pricing, will be determined by your inventory management. In other words, you will know what the correct inventory turnover rate should be for your business and the age aspect of your stock. (Rates are available from retail associations, accountants, Statistics Canada.)

If by adjusting your retail prices you can move the inventory as a whole (if needed) or move certain items, you may decide to have a special sale. This recognizes the fact that it may, at times, be better to sell more items at say 20% markup on cost than less items at a 30% markup. Dead or slow moving stock which, for too long a time, has tied up money and valuable space, is sometimes sold by the retailer with no markup or even at less than cost so as to realize cash. Many retailers have also found it wiser to give a substantial reduction in price immediately and sell the slow moving stock than to make small price reductions in stages when they find the stock is not moving quickly enough. Price reductions in stages defeat the idea of a sale. People who have purchased at 10% off will not be happy when they see a sale extended with the same items marked 20% off. The next time there is a sale, and if they plan to buy at all, they will probably wait for further reductions. Sales should be short and attractive and be a marked contrast to regular prices.

Competition is your single major factor affecting your retail prices. If a retailer in direct competition to you is selling a product for $12.99 and your price is $14.39, chances are that, other things being equal, your customers will purchase at you competitor. This is why retailers do comparative "shopping" of their own by both visiting their competitors' shops and checking their competitors' advertisements. Be sure that *exactly* the same product is involved when comparing prices with your competitors. Model, size, weight, grade, etc. and quantities on hand must be the same. Often advertisements do not give all the product information.

In many cases, other tactics may have to be used to compete pricewise. This is especially true with the small retailer whose competition is a franchise or chain store or a giant retailer. The alternatives are the use of private brand merchandise that is not in direct price competition, or the use of non-price factors such as convenience hours, personal service, and presentation.

Demand is the measurement of the customers' wish to purchase a commodity. If the demand for a certain product or product line is high, then the retailer can charge a high markup. Though often a retailer in a situation of high demand will try for a larger sales volume by either keeping the normal markup or actually reducing it slightly. If the demand is low or nonexistent, the retailer will have to adjust his prices accordingly and use all strategy necessary to induce customers to purchase.

Demand is conditioned by supply, by seasons, by holidays and by trends. Demand which is a result of a trendy or gimmicky product must be handled carefully by the retailer. Good management must ensure that you take advantage of a trend in its early stages. You don't want to end up with a large stock of the novelty item and find the trend finished. No matter how much you lower your retail prices, you will have difficulty selling a passé novelty.

Psychology is also a factor affecting your retail pricing strategy. An item selling for $29.99 has more consumer price appeal than the same item at $30.00. The dollar figure is what registers first with most consumers.

Many retailers purposefully avoid ending their retail prices in even numbers or in 5's. This is especially true with items selling for less than one dollar. For example, if the normal markup on cost brings the retail price to 40¢, the retailer may show the retail price as 39¢ or 41¢ or 43¢. Most consumers, when seeing such odd numbers, will subconsciously think the price is *less* than what they were numerically expecting. The 39¢ price is thought of as *less* than 40¢ and the 41¢ and 43¢ prices as being *less* than 45¢. If the price was shown as 40¢ or 45¢ there would not be this subconscious reaction.

You must also remember the psychological aspect of setting prices on an individual basis and, at the same time, as a double unit. An example of double unit pricing is $1.29 each or two for $2.57. Some consumers will, for arithmetic ease, round the original price to the nearest 5 or 10 figure and double it to compare with the price for two. In this case, the comparison will be $2.60 against $2.57.

In adjusting retail prices psychologically on items costing less than a dollar, you must realize that this is affecting your gross trading profit. A retail price going from 40¢ to 39¢ means a 3% loss of margin on selling. While an increase from 34¢ to 37¢ means almost a 10% gain of margin on selling.

Economic conditions are usually a retail pricing factor that you can do little to change, but which you should consider closely. The economic situation of a region or locality may be booming or can be depressed. A depressed economy with high unemployment could mean you have to lower your markup on cost, while a healthy economy should permit larger markups. Your retail area may be one that has an intense summer tourist trade at which time your markups may be higher than during the rest of the year. Your area could also be one whose work force is affected by seasons such as forestry or fishing. In the off seasons, you may have to reduce your markup. There are some towns whose principal employer is a single company and, depending on the fortunes of the company (layoffs, overtime, new hiring), the town's retailers will adjust their selling prices accordingly.

Markdown and Loss leaders

We have looked at markup on cost, so we should now look at the concept of markdown and the use of loss leaders.

Markdown should correctly be termed "markdown on selling" and be viewed simply as a decrease in the selling price. Markdown can be calculated as either a dollar figure or a percentage of the original selling price. For example, "25% off" means that, if an item was selling for $13.99, the marked down price would be $13.99 x 25% = $3.50; $13.99 – $3.50 = $10.49.

It is important to remember that a decrease in the selling price will mean that your markup on cost has been reduced but *not* by the same percentage. In the above example, if our item costs $9.79 and sold for $13.99 then the markup on cost was $4.20 or 42.9% (30% margin on selling). The decreased selling price is $10.49 which means a markup on cost of only $0.70 or 7.2%. The 25% off selling has meant the markup on cost has been reduced not by 25% but by 35.7%.

From the above, it becomes apparent that markdowns should not be indiscriminately applied. Remember your product mix and that your overall sales must give you your required gross trading profit. Markdowns should therefore be mainly used in cases such as having dead or slow moving stock, sudden competition on a particular item, or having initially priced an item too high.

Of course, in knowing your product mix and mix of markups, you may have also found that you have reached the requested unit volume of sales on a particular item and can afford to lower your markup to attract customers.

Loss leaders are items that are sold at very attractive prices for consumers. The purpose is to generate customer traffic in your shop. The hope is that these customers, as well as buying the loss leader, will either make other purchases of regular stock or will return remembering your shop's low prices.

The use of loss leaders is usually for a short-term basis and is accompanied by sales promotion. There are mainly two sources for these loss leaders. The first source is your own stock where you decide to knock down the selling price of a particular item. (Note that usually you will not use dead or slow moving stock as loss leaders). The second source is the wholesaler or manufacturer who will specifically sell items to the retailer at reduced prices.These can be items new to the market or currently in favour. Often the wholesaler or manufacturer is able to supply promotional material such as posters and flyers. If more than one retailer in a given area is involved with a loss leader, sometimes common advertising in newspapers or on radio is arranged.

Note: Retailers must comply with consumer protection laws that can ask a retailer to prove the original selling price.* For example, if you are selling an item at $10.49 and the original selling price was $13.99 you cannot, by law, show the original price as being $19.99. Be careful of your use of such words as "regularly", "was", "originally", "reduced from" in reference to your retail prices. You may be asked to prove a "was" price and, if you cannot, your business is liable to be fined.

Before you increase the retail price

Imagine this situation: The dollar figure for your sales is down and your gross trading profit will soon be insufficient to cover your operating and selling expenses.

Your immediate reaction, under these circumstances, might be to increase your markup. This is a natural reaction as markup has such a direct effect on the gross trading profit.

Most retailers though, before increasing their retail prices, will first see if their *volume* of sales can be increased. Increasing the volume of sales will, in turn, increase their gross trading profit. Increasing the markup will increase the dollar value of sales, but there is a good chance that with higher prices you may lose customers and your volume of sales may go down. If that happens, your higher markups will not have improved the situation at all.

To increase their sales volume, many retailers will look at three areas of their retail business:

- premises
- presentation
- merchandising specials

Premises, and their condition, create both a conscious and subconscious reaction with customers. This is especially true of potential customers who will initially make a judgment of your shop on appearances.

Knowing this initial reaction, you should ensure that your premises are inviting. Well lit, in good repair, painted and clean, are adjectives that usually are applicable to a successful retail business. Shop windows and outside signs deserve special attention as to condition. These are two important facets that are seen first by customers.

The offence is where your price representation is materially misleading. "Material", as used in the expression materially misleading representation, is not the value to the purchaser but rather the degree to which the purchaser is affected by these words in deciding whether or not to purchase. (Section 36 *Combines Investigation Act*)

Presentation has a broad application to your retail business. It should be viewed as making the customer feel welcome and wanted. Signs in your window should be up-to-date and have a professional appearance. Your window display should be current and clean and varied on a rotation basis. Inside your shop your merchandise should be well presented, priced clearly, and have a logical relationship. For example, a hardware store should have all its paints in one section along with brushes and related painting materials. This will show the customer your complete stock types and can induce him or her to buy related products. Your merchandise should also be clean and easily visible. Shelves should look neither overstocked nor bare.

Your salesclerks are a very important aspect of presentation. Are they friendly? Do they make the customers feel wanted or do they idly stand waiting for the customers to come up to them? Are they completely familiar with your merchandise and can they suggest alternate or related items to the customers? In non-peak hours, do they keep the merchandise tidy and otherwise keep busy?

Merchandising specials is your third method in which to try to increase your sales volume. This is where loss leaders are used or controlled markdowns are taken on popular merchandise. The sale is short and there is extensive advertising both before the actual sale and during the sale itself. The idea behind the sale is to induce people to purchase your regular stock as well as the sale stock and to remember your store as a place for good prices.

When you finally have to increase your retail prices, do not apply a higher markup to all your stock at one go. Be selective, analyzing which items can take an increase in markup and which items the customer will know are higher. Maybe change brand names and apply the higher markup to the new product so that people associate the higher retail price with the brand name and not so much with the product.

Remember to make your increases in relation to your product mix as described on page 7. Also remember that nothing looks worse than a price sticker applied on top of another one. Two price stickers*, applied in this manner, immediately tell the customer the price has gone up. For, if the retail price had gone down, the customer knows you would clearly show the saving as an encouragement to buy.

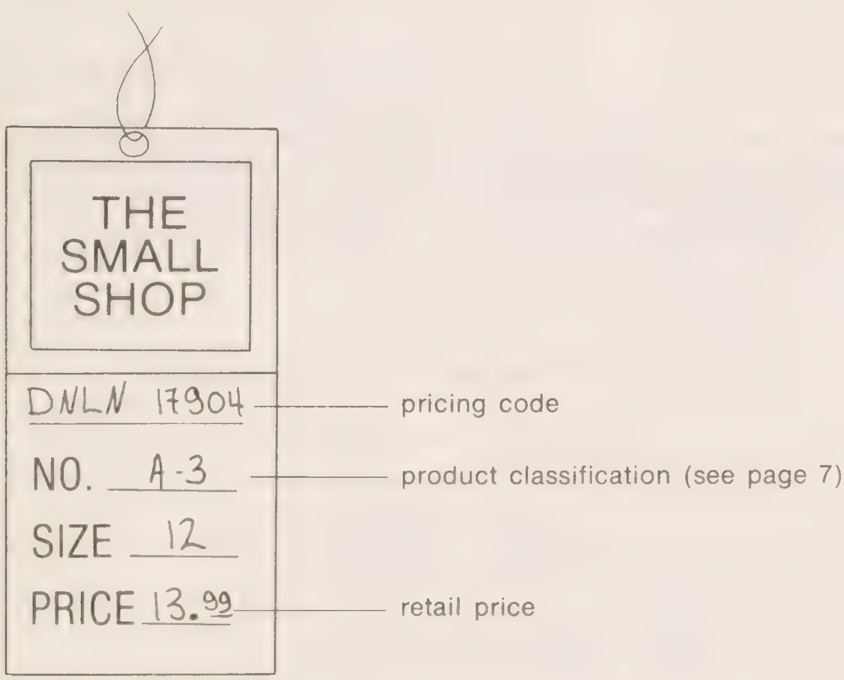
* Where two or more prices are clearly shown on a product, its container or wrapper, etc., the product must be supplied at the lower price. This provision does not actually prohibit the existence of two or more prices but requires that the product be offered for sale at the lower price. (Section 36.2 *Combines Investigation Act*)

A pricing code system

At the beginning of this booklet and throughout the text, we have stressed the importance of constantly monitoring your pricing strategy and knowing your merchandise. Knowing your merchandise means knowing when you purchased the product, how much it cost you, what the markup is, and what the selling price is.

It is important to know these facts about your merchandise as they are mandatory for any decisions that you make in price adjustments. How do retailers obtain this information so quickly? We have all seen the situation where a customer is hesitating over a purchase and the retailer, giving a quick glance at the price tag, makes a special price and the customer buys. A retailer may suddenly put a certain product line on sale for a few days or maybe, once a week, have a regular advertised special. How is this done so quickly?

While decisions of pricing strategy are backed up by accounting and inventory records, many retailers by referring to their retail price tags are able to avail themselves of immediate merchandise information. Let us look at a retailer's price tag and see what is on the price tag, in addition to the retail price.



Our retailer giving a quick glance at the above price tag knows, by the pricing code, that the item's total original cost is $9.79 and was taken into inventory in April 1979. The markup on the cost is $4.20. With this information, our retailer is able to make a decision on a price adjustment if the sales conditions so warrant.

To establish such a pricing code, take any 10 letter word that does not repeat any letters and, in order, assign each letter with a number from 1 to 0. In the above example, our retailer used:

C U M B E R L A N D
1 2 3 4 5 6 7 8 9 0

The original cost of this tagged item was $9.79 or:

D N L N
0 9 7 9

The second part of the code establishes the date the item was taken into inventory. In our example:

1	7 9	0 4
nonsense number	last 2 digits of year	month

The above pricing code is but an example. Any code can be used that serves your purpose, but remember that it must be a simple code that you can learn and read as easily as you would the actual information. But be sure that your pricing code is not so uncomplicated that your customers will decipher it. Especially with the code for age of the item, you may wish to add some more nonsense numbers to avoid detection.

A pricing checklist

This section consists of a checklist for you to complete. Some of the questions have been examined in this booklet, while other questions are there as an inducement for you to enquire further into the aspects of retail pricing. You may also wish to periodically use this checklist as an aid in monitoring your pricing strategy.

Questions

Markup on cost and Margin on selling:	**YES**	**NO**
Do you know what markup on cost is?	☐	☐
Do you know what cost of merchandise includes?	☐	☐
Can you calculate markup on cost as a percentage?	☐	☐
Do you know what margin on selling is?	☐	☐
Do you know the formula for finding percentage of margin on selling?	☐	☐
Do you really know the difference between markup on cost and margin on selling?	☐	☐

Finding the established markups:		
Will you contact a wholesaler for markup information?	☐	☐
Will you use the manufacturer's suggested list price?	☐	☐
Can other retailers supply you with markup information?	☐	☐
Could an accountant or auditor give you markup information?	☐	☐
Are you going to visit suppliers and manufacturers?	☐	☐
Can a retail association help you?	☐	☐
Have you found the average markup on cost for the merchandise you will sell?	☐	☐

Can you afford the established markup?	YES	NO
Do you know what a markup on cost must cover?	☐	☐
Have you prepared a forecast to check what markup you can afford?	☐	☐
Are your yearly operating and selling expenses estimated accurately?	☐	☐
Have you calculated cost of goods sold in relation to your sales volume?	☐	☐
Is your sales figure accurate?	☐	☐
Have you analyzed your sales figure?	☐	☐
Have you correctly applied your markup on cost to your cost of goods sold?	☐	☐
Will your gross trading profit be sufficient to cover all operating and selling expenses and give you an adequate return?	☐	☐
Will your business be viable at the established markup?	☐	☐
The product mix:		
Do you know your mix of products and markups?	☐	☐
Have you estimated the sales volume of each product?	☐	☐
Will you know when you can adjust your markups?	☐	☐
Factors affecting retail prices:		
Do you know why a wholesaler would reduce the wholesale price to you?	☐	☐
Have you decided what to do with your markup if the wholesale price is reduced?	☐	☐
Do you know why a wholesale price will go up?	☐	☐
Will you spread the wholesale price increase over both old and new stock?	☐	☐
Do you know the correct inventory turnover rate for your business?	☐	☐
Do you know the age of your stock?	☐	☐
Do you realize what dead or slow moving stock means?	☐	☐
Do you know why a sale should be short and attractive?	☐	☐
Do you know at all times what your competitors are charging?	☐	☐
Do you visit your competitors and check their advertising?	☐	☐
Do you know the effects created by demand, both high and low?	☐	☐
Are you selling a novelty or seasonal item and are you aware of the risks?	☐	☐
Do you know the psychology of pricing?	☐	☐
Do you end your prices in odd numbers?	☐	☐
Do you offer quantity prices to your retail customers?	☐	☐
Are you aware that your margin on selling will change when adjusting your prices psychologically?	☐	☐
Have you considered the economic conditions of your area or region and will you adjust your markup accordingly?	☐	☐

Markdown and Loss leaders:

	YES	NO
Can you define a markdown?	☐	☐
Can you calculate markdown in relation to the original selling price?	☐	☐
Do you know when to apply markdowns?	☐	☐
Can you define a loss leader?	☐	☐
Do you know the sources of loss leaders?	☐	☐
Do you know when to use loss leaders?	☐	☐
Are you aware of consumer protection laws in reference to false pricing?	☐	☐
Before you increase the retail price:		
Can you increase your sales volume to boost your gross trading profit?	☐	☐
Do you know three methods for increasing sales volume?	☐	☐
Are your premises inviting?	☐	☐
Is your merchandise well presented?	☐	☐
Are your clerks friendly and knowledgeable about your merchandise?	☐	☐
Do you know how to use merchandising specials?	☐	☐
Do you know what is involved in an increase in your retail prices?	☐	☐
A pricing code system:		
Do you have quick and accurate knowledge of your merchandise?	☐	☐
Have you a pricing code system?	☐	☐
Are you familiar and at ease with your pricing code system?	☐	☐

Conclusion

Retail pricing, which is a crucial art to a retailer, cannot be taught or learnt in a few easy lessons. Retail pricing, like all aspects of good management, must be constantly worked at. The results of a successful retail pricing strategy, good retail prices, should really be referred to as good management.

We hope the booklet has helped you understand some aspects of retail pricing. If you have any questions about anything that you have read, or feel that we have missed something on which you need help, please feel free to contact Management Services at any branch of the Federal Business Development Bank. We are there to help small businesses help themselves.

CASE
Counselling Assistance to Small Enterprises

The Federal Business Development Bank's Management Counselling Services known as CASE (Counselling Assistance to Small Enterprises) assists small businesses in Canada to improve their methods of doing business.

Virtually any established business or anyone about to engage in a business enterprise can apply provided it has had prior discussion of its needs with its appropriate business advisor(s), and provided it has no more than seventy-five employees.

This service is provided at a moderate fee and supplements counselling services obtainable from the private sector. The counselling is performed by retired business persons selected for their management experience.

To obtain more details on CASE, contact any of the CASE offices listed below or any FBDB branch office.

CASE Offices

City	Street	Telephone
Atlantic Region		
CHARLOTTETOWN	139 Kent Street	(902) 892-3576
CORNER BROOK	4A Herald Avenue, 3rd Floor	(709) 639-9126
FREDERICTON	440 King Street, Suite 646	(506) 452-3022
HALIFAX	Cogswell Tower, Suite 706	(902) 426-2474
MONCTON	860 Main Street, Suite 702	(506) 858-2973
ST. JOHN'S	Beothuck Building, 4th Floor	(709) 737-5515
SYDNEY	48-50 Dorchester Street	(902) 539-8010
Quebec Region		
CHICOUTIMI	475 des Champs Elysées Street	(418) 545-1501
LAVAL	2525 Marois Boulevard	(514) 681-9291
LONGUEUIL	1000 de Sérigny Street	(514) 670-0633
MONTREAL	800 Victoria Square	(514) 283-4384
QUEBEC	925 Chemin St. Louis	(418) 694-3003
ST. LAURENT	750 Laurentien Boulevard	(514) 748-7323
SHERBROOKE	2532 King Street West	(819) 565-4740
TROIS-RIVIÈRES	1410 des Cyprès Street	(819) 375-1621
Ontario Region		
HAMILTON	8 Main Street East	(416) 523-2954
KITCHENER-WATERLOO	305 King Street West	(519) 744-4186
LONDON	197 York Street, Suite 100	(519) 432-6705
OSHAWA	22 King Street West	(416) 571-1355
OTTAWA	151 Sparks Street, Suite 1005	(613) 238-6253
SAULT STE. MARIE	421 Bay Street	(705) 949-1997
THUNDER BAY	106 Centennial Square	(807) 623-2745
TORONTO	204 Richmond Street West, 5th Floor	(416) 593-1143
TORONTO NORTH	4430 Bathurst Street, Downsview	(416) 638-1340
WINDSOR	500 Ouellette Avenue	(519) 254-8626
Prairie & Northern Region		
BRANDON	1011 Rosser Avenue, Suite 603	(204) 727-8415
CALGARY	404 Sixth Avenue South-West	(403) 269-6981
EDMONTON	9803-102A Avenue	(403) 428-9264
LETHBRIDGE	740-4th Avenue South	(403) 328-9681
REGINA	2220-12th Avenue	(306) 569-6478
SASKATOON	1203 CN Towers	(306) 665-4050
WINNIPEG	386 Broadway Avenue, Suite 101	(204) 944-9991
British Columbia Region		
CRANBROOK	30 South 11th Avenue	(604) 426-7241
KAMLOOPS	235 First Avenue	(604) 374-2121
KELOWNA	260 Harvey Avenue	(604) 762-2035
NANAIMO	190 Wallace Street	(604) 753-2471
NEW WESTMINSTER	227 Sixth Street	(604) 525-1011
NORTH VANCOUVER	145 West 15th Street	(604) 980-6571
PRINCE GEORGE	1320 Fifth Avenue	(602) 563-0641
VANCOUVER	885 Dunsmuir Street	(604) 681-7484
VICTORIA	990 Fort Street	(604) 388-0161

FBDB Branch Offices

Atlantic Region

Bathurst, N.B. 548-3345
270 Douglas Avenue
E2A 1M9

Bridgewater, N.S. 543-7821
655 King Street
B4V 1B5

Charlottetown, P.E.I. 892-9151
137 Kent Street
C1A 1N3

Corner Brook, Nfld. 639-7113
Herald Tower, Herald Ave.
A2H 4B4

Edmundston, N.B. 739-8311
109 Rice Street
E3V 1T3

Fredericton, N.B. 452-3030
King's Place Complex
440 King St., Suite 649
E3B 5H8

Grand Falls, Nfld. 489-2181
42 High Street
A2A 1C6

Halifax, N.S. 426-7850
Suite 710, Cogswell Tower
Scotia Square, B3J 3K1

Moncton, N.B. 858-2370
860 Main Street
E1C 1G2

Saint John, N.B. 658-4751
75 Prince William Street
E2L 2B2

St. John's, Nfld. 737-5505
Beothuck Bldg., Crosbie Place
A1B 3Y8

Sydney, N.S. 539-4556
48-50 Dorchester Street
B1P 5Z1

Truro, N.S. 895-6377
CN Commercial Centre
34 Esplanade St., B2N 2K3

Quebec Region

Chicoutimi 545-1580
475 des Champs Elysées St.
G7H 5V7

Drummondville 478-4951
228 Hériot Street
J2C 1K1

Granby 372-5202
161 Principale Street
J2G 2V5

Hull 997-4434
Plaza Val Tétreau
400 Alexandre Taché Blvd.
J9A 1M5

Lasalle 364-4410
1550 Dollard Avenue
H8N 1T6

Laval 681-9289
2525 Marois Boulevard
Chomedey, Laval
H7T 1S9

Lévis 837-0282
113 St. Georges Street West
G6V 4L2

Longueuil 670-9550
Complexe Bienville
1000 de Sérigny St.,
J4K 5B1

Montréal 878-9571
800 Victoria Square, Suite 1008
H4Z 1C8

Place Frontenac 524-1188
2600 Ontario Street East
Suite 205, H2K 4K4

Québec 681-6341
925 Chemin St. Louis
G1S 1C1

Rimouski 724-4461
320 St. Germain Street East
G5L 1C2

Rouyn-Noranda 764-6701
147 Mercier Avenue
Rouyn, J9X 4X4

St-Jérôme 436-6441
Galeries des Laurentides
St. Antoine des Laurentides
J7Z 5V3

St-Laurent 748-7323
750 Laurentien Boulevard
H4M 2M4

St-Léonard 254-6073
5960 Jean Talon Street East
H1S 1M2

Sept-Iles 968-1420
690 Laure Blvd., Suite 152
G4R 1X9

Sherbrooke 565-4740
2532 King Street West
J1J 2E8

Trois-Rivières 375-1621
1410 des Cyprès Street
G8Y 4S3

Valleyfield 371-0611
85 Champlain Street
J6T 1W4

Ontario Region

Barrie 728-6072
70 Collier Street
L4M 1G8

Chatham 354-8833
59 Adelaide Street South
N7M 4R1

Etobicoke 239-4804
Valhalla Executive Centre
304 The East Mall
Islington, M9B 6E2

Hamilton 523-2954
8 Main Street East
L8N 1E8

Kenora 468-5575
20 Main Street South
P9N 1S7

Kingston 549-1531
Plaza 16
16 Bath Road, K7L 1H4

Kitchener-Waterloo 744-4186
305 King Street West
Kitchener, N2G 1B9

London 434-2144
197 York Street, Suite 1000
N6A 1B2

North Bay 476-4123
205 Main Street East
P1B 1B2

Oakville 844-0911
345 Lakeshore Road East
L6J 1J5

Oshawa 576-6800
22 King Street West
L1H 1A3

Ottawa 237-8430
151 Sparks Street, Suite 1012
K1P 5E3

Owen Sound 376-4431
1139 Second Avenue East
N4K 2J1

Peterborough 748-3241
340 George Street North
K9H 7E8

St. Catharines 684-1153
71 King Street
L2R 3H6

Sault Ste. Marie 949-3680
452 Albert Street East
P6A 2J8

Scarborough 431-541
2978 Eglinton Avenue East
M1J 2E7

FBDB Branch Offices (Cont'd)

Ontario Region

Stratford 271-5650
1036 Ontario Street
N5A 6Z3

Sudbury 674-8347
96 Larch Street
P3E 1C1

Thunder Bay 623-2745
106 Centennial Square
P7E 1H3

Timmins 264-9432
83 Algonquin Boulevard West
P4N 2R4

Toronto 598-0341
204 Richmond Street West
M5V 1V6

Toronto North 638-0823
4430 Bathurst Street
Downsview, M3H 3S3

Windsor 254-8626
500 Ouellette Avenue
N9A 1B3

Woodstock 537-5846
430 Dundas Street
N4S 1C1

Prairie and Northern Region

Brandon, Man. 727-8415
136-11th Street
R7A 4J4

Calgary, Alta. 269-6981
404 Sixth Avenue South-West
T2P 0R9

Calgary South, Alta. 253-6501
5940 MacLeod Trail South-West
T2H 2G4

Edmonton, Alta. 428-9111
9803-102A Avenue
T5J 3A3

Edmonton South, Alta. 436-6533
11044-51st Avenue
T6H 5B4

Edmonton West, Alta. 452-3232
11574-149th Street
T5M 1W7

Grande Prairie, Alta. 532-8875
10135-101st Avenue
T8V 0Y4

Lethbridge, Alta. 328-9681
740-4th Avenue South
T1J 0N9

Medicine Hat, Alta. 527-2602
Medicine Hat Inn
530-4th Street South-East
T1A 0K8

Prince Albert, Sask. 764-6448
1100-1st Avenue East
S6V 2A7

Red Deer, Alta. 343-3232
4919-59th Street
T4N 6C9

Regina, Sask. 569-6478
2220-12th Avenue
S4P 0M8

St-Boniface, Man. 233-6791
Bay 6 West
851 Lagimodière Boulevard
Winnipeg, R2J 3K4

Saskatoon, Sask. 665-4822
1102 CN Towers
Midtown Plaza, S7K 1J5

Whitehorse, Y.T. 667-7333
Travelodge Commercial Mall

Winnipeg, Man. 944-9991
386 Broadway Avenue
R3C 3R6

Yellowknife, N.W.T. 873-3566
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X1A 1C8

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V8G 1P8

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V6C 1N7

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